INFORMAL SESSION TO ENGAGE

FO/DIS/22/125

September 2, 2022

To: Members of the Executive Board

From: The Secretary

Subject: **Proposal for a New Food Shock Window Under the Rapid Financing Instrument and Rapid Credit Facility**

Board Action:	**Informal session to engage** Executive Directors
Tentative Board Date:	**Monday, September 12, 2022**
Issues for Discussion:	Page 8
Publication:	Not proposed, as this is a preliminary discussion.
Questions:	Mr. Rother, SPR (ext. 34256) Ms. Rosenberg, LEG (ext. 37790) Mr. Hatanpaa, FIN (ext. 35484) Mr. Kim, SPR (ext. 34916)

INTERNATIONAL MONETARY FUND

September 2, 2022

PROPOSAL FOR A NEW FOOD SHOCK WINDOW UNDER THE RAPID FINANCING INSTRUMENT AND RAPID CREDIT FACILITY

EXECUTIVE SUMMARY

Russia's war in Ukraine has exacerbated economic pressures for the Fund's member countries, including food insecurity. For many countries facing urgent balance-of-payments (BOP) pressures, the best response would involve an Upper Credit Tranche (UCT) quality program. To quickly help those member countries whose urgent BOP pressures are related to the global food shock and for which a UCT-quality program is either not feasible or not necessary, this paper proposes a new, time-bound food shock window under the Rapid Financing Instrument (RFI) and the Rapid Credit Facility (RCF). This window would provide low-access emergency financing for urgent BOP needs associated with the rising costs of food and fertilizer imports or substantial cereal export receipt shortfalls. The window would be available for 12 months from the date of its establishment by the Board. Countries would only be granted access to the new window if standard qualifying conditions for emergency financing under the RFI/RCF are met. Countries that do not meet the qualification for the new window, but are facing an urgent BOP need in a situation where a UCT-quality program is not feasible or not needed, could access financing under the other windows of the RFI and RCF if the relevant qualification is met.

Under staff's preliminary proposal, the outright purchases under the food shock window would be conditional on countries meeting a set of qualification criteria associated with the global food crisis, either because of higher food and fertilizer import prices or cereal export revenue shortfalls. Total access under the new window would be capped at 50 percent of quota and would be additional to the current annual access limits under the RFI/RCF. Where a member requests financing under the new window, the cumulative limit under the RFI regular "window" as well as under the RCF exogenous shock window (currently at 150 percent of quota) would be increased to 175 percent of quota. Financing under the new window, similar to the other windows, would be counted toward the GRA and PRGT access limits.

Consistent with the Fund's lending framework, access under the food shock window would require an assessment that debt is (or will be made) sustainable and the country has capacity to repay the Fund. For countries where debt is currently unsustainable, this will require the member to take measures to restore debt sustainability. The number of countries with unsustainable debt remains, however, limited at this stage. For countries

where there is an ongoing concerted international effort to provide substantial new financing or debt relief or there is significant outstanding credit to the Fund, a monitoring of policies under the newly proposed Program Monitoring with Board Involvement (PMB) could usefully accompany access under the food shock window.

The proposed new window would raise PRGT lending above the baseline scenario on which the SDR 2.3 billion subsidy need is based, requiring additional commitments of subsidy resources. It would also increase the urgency of attaining the target for loan resources, including through additional SDR channeling to support the most vulnerable (PRGT-eligible) countries.

THE CASE FOR A NEW FOOD SHOCK WINDOW

1. The war in Ukraine has added to economic pressures on the Fund's member countries, including by further worsening food insecurity. Food price pressures have been building for a number of years already before the war, including due to the negative effect of the COVID pandemic and climate shocks. For many member countries, the war in Ukraine has made a difficult situation worse through record food price inflation, increasing costs for fertilizers, and shortages in food supplies and particularly cereals. While food and fertilizer prices have recently eased from peak levels, they are still significantly higher than in 2020-2021 and substantial risks to the price outlook remain. Ukraine's exports of cereals will continue to be constrained relative to pre-war levels due to logistical issues. Moreover, there is a high likelihood that food availability and access challenges will continue into 2023 and become more serious as fertilizer shortages and protectionist measures affect future harvests and global trade flows. As a result of these dynamics, which add to other pressures including sharply increased energy costs and rising interest rates as central banks address accelerating inflation, many member countries are now facing serious hardship and urgent balance of payments needs.

2. The Fund's current lending toolkit is not optimally calibrated to help members address urgent BOP needs associated with the food shock exacerbated by the war in Ukraine. In general, the best option for the Fund to help countries cope with such pressures involves UCT-quality programs. In addition, the Fund offers emergency financing under the existing RFI/RCF windows in situations where UCT programs are not feasible in a timely manner (either due to the urgency of the member's BOP need or its limited policy implementation capacity) or not needed to address BOP needs (because of the transitory nature of the need). Currently, most member countries could access these existing emergency financing instruments up to 50 percent of quota, which is the annual access limit under the RCF exogenous shock window and RFI regular window. The borrowing space is, however, very limited for some countries.[1] More broadly, this existing borrowing space does not account for the potential needs associated with the current global food crisis. The latter was not anticipated at the time of the recalibration of RCF/RFI access limits in December 2021 that was confined to ensuring adequate access to emergency financing instruments during the coming years to cope with "typical" country/region-specific shocks as experienced during the decade prior to the COVID-19 pandemic.

3. The new window could be a first step to support members facing an urgent BOP need related to the global food shock with a broader range of Fund financing instruments. This would make the Fund's lending toolkit more agile in addressing members' financing needs in cases

[1] These include seven countries with outstanding exposures of over 100 percent of quota due to earlier RCF access in the context of natural disasters and the Covid-19 pandemic. Specifically, borrowing space under the RCF is constrained for the following countries (available space is reported in brackets): Dominica (29 percent of quota), Madagascar (39 percent of quota), Mozambique (13 percent of quota), Nepal (36 percent of quota), St. Vincent and the Grenadines (0 percent of quota), Samoa (46 percent of quota), and Ukraine (no remaining borrowing space under the annual access limits after the RFI in March 2022). Madagascar, Mozambique, and Nepal have on-track UCT program. For them, urgent balance of payment needs arising from the food and fertilizer shocks could be addressed through an augmentation under their existing program.

where UCT-quality programs are not feasible or not needed. Consistent with the criteria under the existing RFI/RCF policies, access under the food shock window of up to 50 percent of quota would increase existing borrowing space to help countries address urgent BOP needs emanating from the impact of the war in Ukraine on their food exports or imports and help alleviate the risk of a systemic global food crisis. In some cases, the new food shock window could act as a bridge: where needed and once feasible, countries that access the food shock window could move towards UCT-quality programs.

4. **Other options to quickly enhance the toolkit look less attractive.** While a similar objective could in principle be achieved by a general increase in access limits under the existing windows of the RFI/RCF, creating a new, time bound, and food-related window would help better target Fund financing and avoid the risk of incentivizing some countries to request non-food emergency financing and delay necessary adjustment further. The food shock window would be temporary, with its availability limited to 12 months from Board approval of the window, which could be sought before the 2022 Annual Meetings.

QUALIFICATION

5. **Standard criteria for RFI/RCF would apply to the food shock window.** To approve emergency financing under the RFI/RCF, the Fund needs to be satisfied that the member has an urgent BOP need and that the member either (i) has a BOP need that is expected to be resolved within one year with no major policy adjustments being necessary or (ii) is unable to design or implement an UCT-quality program, either given the urgent nature of the BOP need or due to its limited implementation capacity. The new window under the RFI would be available to all Fund member countries meeting these conditions, and PRGT-eligible members would also have access to a similar window under the RCF.

6. **In addition, the member's urgent BOP need would have to be related to the global food shock.**[2] To help ensure that the food shock window does not create an incentive to delay necessary policy adjustment, qualification for access under this window would be tightly circumscribed to cover an urgent BOP need related to the global food shock. Specifically, based on preliminary analysis, qualification could be limited to members facing an urgent BOP need associated with either (i) a situation of acute food insecurity or an increase in food/fertilizer import costs exceeding a certain threshold or/and (ii) a cereal export shortfall exceeding a certain threshold. The calibration of these criteria necessarily involves some judgment. They are designed to include a maximum of those countries that are severely affected by the food shock while not casting qualification so wide as to disincentivize others from accessing financing instruments that may be more adequate for their specific situations, in particular UCT-quality programs that in many cases will be needed to help resolve BOP needs with ex post conditionality.

[2] In cases of an urgent BOP need arising from shocks that are not related to food, members that satisfy the relevant qualification criteria can access other windows of the RFI/RCF.

(i) **Situation of acute food insecurity or impact of the increase in food/fertilizer costs exceeding a certain threshold.**

- Member countries would also qualify for the new window if they have urgent BOP needs associated with an acute food crisis based on the definition of the World Food Program (WFP). This involves meeting one or more of the following criteria: (i) at least 20 percent of the population is in phase 3 or above of the Integrated Food Security Phase Classification/Cadre Harmonisé (IPC/CH); (ii) at least 1 million people are in IPC/CH phase 3 or above; or (iii) any geographical area is in IPC/CH phase 4 or above.

- Net food importers would also qualify for the new window if the negative impact of price changes for food and fertilizers on the external current account amounts to at least 0.3 percent of GDP over a 12-month period.[3] To facilitate the assessment of qualification, the impact of the shock would be analyzed under the assumption of constant import volumes that would reflect pre-war levels.[4]

(ii) **Cereal export shortfall exceeding a certain threshold.** Cereals are the food exports most immediately affected by the war in Ukraine. These staple crops include wheat, maize, barley, sorghum, millet, oats, and rice and are critically important to global food security as they comprise about 50 percent of the calories and proteins that humans consume worldwide.

- For net exporters of cereals suffering from a shock to their export volumes due to impediments to their capacity to produce and/or export, the shock would be assessed based on the projected U.S. dollar value of annual cereal grain exports.

- A country would qualify if the projected negative shock to cereals exports benchmarked against the previous year exceeds 0.8 percent of projected GDP for the compensable year. This threshold is macroeconomically significant and ensures that only shocks above the [95th] percentile of the historical distribution of such negative shocks during 1995-2021 are covered under the window. Since projections for agricultural production are inherently challenging given that yields can be substantially affected by climate, disease, or pests, the analysis should be based on granular data from national authorities, leveraging to the extent possible reputable expert assessments (e.g., USDA, FAO) to fill in missing information.

- A country would not qualify if the drop in export values results from bans or restrictions on cereals exports, since these measures tend to harm food security, especially in import-dependent developing countries.

[3] This threshold is calibrated to include the quartile of countries with the highest negative impact of the shock, in percent of GDP.

[4] Preliminary assessment of this qualification criterion is conducted using cereal prices, as data limitations prevent a more comprehensive analysis for a broader food category.

7. About 30 countries could be eligible for accessing financing under the food shock window. Based on available outturn data, staff's preliminary assessment is that some 50 countries would meet the qualification criterion of either an acute food insecurity crisis, a negative food import price shock of at least 0.3 percent of GDP, or a qualifying export shock (Table 1). However, a significant number of these countries that are currently facing an urgent BOP need related to the global food shock would likely not qualify because a UCT-quality program is already in place or is feasible, or there are government recognition issues or elevated political instability, or debt is not sustainable. These factors would reduce the number of qualifying countries to about 30. In assessing qualification of these remaining countries, the final step would require demonstration of an urgent BOP need[5] and staff judgment that a UCT-quality program is not needed or not feasible.

8. Standard ex-ante policy undertakings would be required. These would be outlined in a Letter of Intent, including that the country will not introduce measures or policies that would compound its BOP problems, and that it will cooperate with the Fund to find, where appropriate, solutions for its BOP difficulties.

9. Other standard policies for RFI/RCF access would apply to the food shock window. This means that purchase/disbursement would be outright without ex-post conditionality, while prior actions could be specified, where warranted under the Guidelines on Conditionality. Since the Fund can only provide its resources under adequate safeguards, as with any UFR, access under this new window would require debt to be sustainable and adequate capacity to repay the Fund. As an outright purchase under the RFI/RCF does not involve a UCT-quality program, a fully financed program would not be required.

ACCESS

10. The food shock window would provide low access emergency financing. Access under the food shock window during the proposed 12-month period would be consistent with the actual balance of payments need but capped at 50 percent of the member's quota. This access would be fully additional to the current annual access limits under the RFI/RCF. Where a member requests financing under the new window, the cumulative access limit under the RFI regular window as well as the RCF exogenous shock window (currently at 150 percent of quota) would be increased to 175 percent of quota. The cumulative access limits under the RFI and RCF Large Natural Disaster windows would remain unchanged (i.e., 183.33 percent of quota). Cumulative access limits under the RCF regular window would also remain unchanged at 100 percent of quota.[6] The modest increase in the cumulative access limit would ensure that countries still have some borrowing space and capacity to deal with other exogenous events, such as natural disasters, as intended in the December 2021 decision on emergency financing access limits, even though at a lower level. Access

[5] An urgent BOP need involves a present BOP need that, if not addressed, would result in immediate and severe economic disruption.

[6] Outstanding disbursements from all RFI/RCF windows are included in calculating cumulative access (SM/19/100, footnote 46).

under the food shock window would count towards the thresholds that trigger exceptional access safeguards for GRA and PRGT, including GRA/PRGT high combined credit safeguards.

11. Access limits would be reviewed in 2023. The proposed increase in cumulative access limits would be reviewed as part of the exit strategy from higher access limits under the emergency instruments that will be presented to the Board by end-June 2023.

IMPLICATIONS FOR PRGT FINANCING

12. The proposed food shock window comes at a time when PRGT finances are already strained. This reflects the unprecedented concessional lending driven by the pandemic. To support the higher access limits adopted in July 2021, the Board agreed the Fund would seek bilateral contributions of SDR 2.3 billion in subsidy resources and SDR 12.6 billion in loan resources.[7] While about two-thirds of the loan resources have been pledged, only about 40 percent of the required subsidies have been pledged, although these targets were adopted over a year ago. Renewed commitments by bilateral creditors and donors to complete this fundraising are key to enable the PRGT to support sustained recovery of LICs from multiple shocks. Moreover, the reserve coverage ratio, historically averaging around 40 percent, has recently fallen to 26 percent and with the significant lending envisaged over the medium term could approach the 20 percent threshold that may complicate mobilizing loan resources for the PRGT.

13. Additional subsidy resources would be needed. The proposed new window would take PRGT lending above the baseline scenario on which the SDR 2.3 billion subsidy need is based. The additional subsidy resources required will depend on the country qualification and access parameters adopted, but a new window that would provide an additional SDR 1-2 billion in new lending would require around SDR 160-320 million in additional subsidy resources. If there is support for a new window, it will be important to seek commitments for a higher subsidy target at the same time. Subsidy resources should, as far as possible, be provided to the new Subsidy Reserve Account, rather than the General Subsidy Account, so they also bolster the PRGT's reserve coverage. Since fundraising for the Loan Account was based on a High Case demand scenario which would be unlikely to be exceeded even with the new window, the SDR 12.6 billion loan target could remain unchanged, though the urgency of achieving this target, including through additional SDR channeling to low-income countries, would be increased.

OTHER CONSIDERATIONS

14. Countries with unsustainable debt. Consistent with the Articles of Agreement, as with any use of Fund resources, the Fund is precluded from providing financing in cases where a member's debt is unsustainable, unless the member takes steps to restore debt sustainability and demonstrates capacity to repay the Fund. Such steps could include a debt restructuring and/or

[7] The overall target for subsidy resources is SDR 2.8 billion, with SDR 0.5 billion coming from suspension of PRGT reimbursement to the GRA for administrative expenses through FY2026.

adequate assurances from official bilateral creditors on debt relief and/or new financing. In such cases, strong engagement by creditors and donors to provide sufficient and timely debt relief and/or new grant and highly-concessional financing would be critical for countries facing a food shock to access the new window.

15. Monitoring of policies. For countries where (i) there is an ongoing concerted international effort by creditors or donors to provide substantial new financing or debt relief or (ii) there is significant outstanding Fund credit, the member would be strongly encouraged to request a monitoring of policies under the newly proposed SMPs with targeted Board involvement under specific circumstances (see staff note on a Proposed "Program Monitoring with Board Involvement" or "PMB").

ISSUES FOR DISCUSSION

(i) Do Directors agree with staff's assessment on the need to create a new time-bound food shock window under the Rapid Financing Instrument and the Rapid Credit Facility?

(ii) Do Directors agree with the proposed qualification criteria (both design and qualification thresholds) and access limits?

(iii) Do Directors agree that there is a need for higher commitments of PRGT subsidy resources in order to finance the new window?

Table 1. List of Countries Severely Affected by The Food Shock [1/]
(50 countries)

Afghanistan
Algeria
Angola
Bangladesh
Benin
Burkina Faso
Burundi
Cabo Verde
Cameroon
Central African Republic
Chad
Democratic Republic of the Congo
Djibouti
El Salvador
Eswatini
Ethiopia
Guatemala
Guinea
Haiti
Honduras
Kenya
Lebanon
Lesotho
Libya
Madagascar
Malawi
Mali
Mauritania
Moldova
Mozambique
Namibia
Nepal
Nicaragua
Niger
Nigeria
Pakistan
Sierra Leone
Somalia
South Sudan
Sri Lanka
Sudan
Syria
Tajikistan
Thailand
Uganda
Ukraine
Vietnam
Yemen
Zambia
Zimbabwe

1/ Countries identified as having either (a) acute food insecurity according to UNGRC/WFP/FAO; (b) impact of cereal+fertilizer price shock > 0.3% of GDP; or (c) negative shock to cereals exports > 0.8% of GDP.

Notes: Shaded countries have ongoing on-track UCT programs. On-track defined as having completed a review in the past year (i.e. since September 1, 2021).