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EBS/83/171

CONFIDENTIAL

August 12, 1983

To: Members of the Executive Board
From: The Acting Secretary
Subject: Requirement of Cooperation Under the Compensatory Financing
Facility

The attached note considers further the application of the requirement of cooperation under the compensatory financing facility, and serves as background material for the Executive Board discussion on enlarged access scheduled for Wednesday, August 31, 1983.

Att: (1)

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

Requirement of Cooperation Under the Compensatory Financing Facility

Prepared by the Research and the Exchange and
Trade Relations Departments

(In consultation with other departments)

Approved by Wm. C. Hood and C. David Finch

August 12, 1983

At the Executive Board meeting on enlarged access on July 25, 1983, the view was expressed that it would be useful to consider further the application of the requirement of cooperation to purchases in the lower and upper tranches of the CFF. This requirement is stated in the decision (Decision No. 6860-(81/81), adopted May 13, 1981) as follows: Requests for purchases of up to 50 percent of quota will be met "where the Fund is satisfied that ... the member will cooperate with the Fund in an effort to find, where required, appropriate solutions for its balance of payments difficulties;" purchases beyond 50 percent of quota require additionally that "the Fund is satisfied that the member has been cooperating with the Fund in an effort to find, where required, appropriate solutions for its balance of payments difficulties."

The experience with the requirement of cooperation was last discussed in April 1982 (EBM/82/42, 4/5/82) when Executive Directors agreed that past practices relating to judgments on cooperation would continue to be applied on a case-by-case basis. These practices were described in EBS/81/251 which formed the background of that discussion, and updated versions were given in EBS/83/132 and the buff staff statement on July 25, 1983 (83/202).

The application of the test of cooperation depends on each situation, in particular the policies of the member and the nature of the balance of payments problem that it faces. If the member has been following appropriate policies and the payments problem is solely the result of a reversible export shortfall, there is, of course, no need for policy changes, whether the member requests more or less than 50 percent of quota. If, however, the current policies are not satisfactory and the member's difficulties with the balance of payments go beyond the reversible shortfall, Fund assistance must be associated with an effort on

the part of the member to correct its policies. ^{1/} In these circumstances, in considering a request for a lower tranche CFF purchase, the Fund must make a judgment whether the member will in fact be able to deal with its problems in an effective manner. In case of a request for an upper tranche purchase, judgments have also to be made on the adequacy of the effort being made by the member to adjust its policies. In light of this, the staff proposes to interpret the requirement of cooperation as follows:

Lower tranche

The criterion--namely, that the Fund is satisfied that the member will cooperate with the Fund in an effort to find, where required, appropriate solutions for its balance of payments difficulties--implies a willingness to receive Fund missions and to discuss, in good faith, the appropriateness of the member's policies and whether changes in the member's policies are necessary to deal with its balance of payments difficulties. Where management considers that the existing policies of the member in dealing with its balance of payments difficulties are deficient or where the country's record of cooperation in the recent past has been unsatisfactory, management will expect the member to demonstrate its good faith by taking actions, prior to submission of its request for the purchase, that give a reasonable assurance that the policies needed for the correction of the balance of payments will be adopted.

^{1/} This point was stated at the time of the establishment of the facility in February 1963, in Compensatory Financing of Export Fluctuations, A Report by the International Monetary Fund as follows:

If such [a sound set of] policies are being followed, no change in them would be needed to meet payments difficulties that are due solely to temporary situations in foreign markets or to such factors as a temporary fluctuation in crops. The mere fact of a falling off in exports would not be taken as an indication that a corrective program was necessary or that the corrective program already envisaged should be intensified. On the other hand, the need for corrective policies might arise either because the decline in exports appeared to foreshadow a lasting weakening in the country's balance of payments or because (though the export decline itself might be purely temporary and self-correcting) the country's monetary and financial policies were such as to provoke, sooner or later, balance of payments difficulties even under satisfactory export conditions.... In accordance...with the purposes set out in Article I of the Fund's Articles of Agreement, Fund assistance, at least beyond the gold tranche, is not made available to any country that makes no effort to move toward the elimination of those aspects of its exchange and monetary policies that are detrimental to the interests of the member itself or those of other members.

Upper tranche

The additional criterion of the upper tranche--namely, that the Fund is satisfied that a member has been cooperating with the Fund in an effort to find, where required, appropriate solutions for its balance of payments difficulties--means that in the light of the actions taken by the member and the balance of payments policies being pursued the Fund is satisfied with the member's record of cooperation. The existence of a satisfactory balance of payments position (apart from the effects of the shortfall) or the existence of and satisfactory performance under an arrangement with the Fund, or the conclusion of such an arrangement at the time the request for a CFF purchase is made, will be considered to provide evidence of cooperation. However, the existence or the conclusion of an arrangement is not a prerequisite. If a member's current and prospective policies were such as would, in the Fund's view, meet the criteria of the use of resources in the credit tranches, the member would be deemed to have been satisfactorily cooperating with the Fund, even though such use was not contemplated at the time of the CFF request.