FOR AGENDA

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July 25, 1995

To: Members of the Executive Board

From: The Secretary

Subject: Borrowing by the Fund - A Chronological Review

Attached for consideration by the Executive Directors is a paper on a chronological review of the borrowing by the Fund, which serves as background information to the paper on a review of the general arrangements to borrow (EBS/95/117, 7/14/95), and is tentatively scheduled for discussion on Thursday, July 27, 1995. Summary and conclusions appear on pages 30-32.

Mr. Corr (ext. 38774) or Mr. Blalock (ext. 38341) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

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INTERNATIONAL MONETARY FUND

Borrowing by the Fund - A Chronological Review

Prepared by the Treasurer's Department

(In consultation with the Legal Department)

Approved by David Williams

July 25, 1995

Contents | Page

Contents

I. Introduction

At its spring 1995 meeting, the Interim Committee discussed the possibility of borrowing by the Fund as a means of strengthening the adequacy of Fund resources. The communiqué indicated that the Committee "saw a need to examine the issues related to borrowing by the Fund from members and, in particular, the role of the General Arrangements to Borrow." The staff has recently issued a paper on *The General Arrangements to Borrow - A Review*. 1/ The present paper provides background information on borrowing by the Fund, other than under the GAB, and describes the various instances of borrowing in the past. 2/

The Fund's financial structure is founded on the principle that quota *subscriptions provide the basic source of financing for the Fund*, though the Fund may borrow to replenish its currency holdings. Borrowing from member countries, including borrowing outside of the GAB, has played an important role in providing supplemental resources to the Fund at critical junctures over the past 30 years, in particular during the period of large payments imbalances that persisted from the early 1970s until the mid-1980s, when borrowed resources financed some 40-60 percent of Fund credit. The Fund has resorted to borrowing at times of large and prolonged payments imbalances which, on the one hand, warranted a large temporary expansion of Fund credit when deficits were large in relation to members' quotas and, on the other hand, when there was a need to finance that credit expansion through borrowing because the payments surpluses were concentrated either with a relatively small group of members or with members with relatively small quotas and the expansion in credit could be financed only with a sharp decline in the Fund's liquidity. Furthermore, quota reviews often take a considerable amount of time to complete and for the increase in quotas to come into effect. Borrowing has thus provided an important temporary supplement to quota resources from time to time.

The organization of this paper is as follows: Section II discusses some general considerations relating to the financial characteristics of Fund borrowing. Section III describes, chronologically, the main instances of borrowing by the Fund, starting with the borrowing in lire in 1966 and going through the most recent borrowing agreement, concluded with Japan in 1986. This section also reviews the development of the Fund's Guidelines on Borrowing. A summary and conclusions are presented in Section IV.

1/ EBS/95/117 (7/14/95).

2/ This paper does not cover borrowing by the Fund as Trustee, such as in connection with the Enhanced Structural Adjustment Facility.

II. Some General Characteristics of Fund Borrowing

The Fund is a quota-based financial institution. Quota subscriptions provide the basic resources used by the Fund to support the adjustment programs of member countries. Borrowing by the Fund has been of a supplemental nature, undertaken in the light of changing circumstances, including the Fund's liquidity needs and the development of new specific and temporary lending facilities. 1/ Borrowing has been considered appropriate at times when the Fund's current or prospective liquidity was regarded as inadequate, or when, say, the timing and size of a quota increase under a general review of quotas were uncertain, especially in relation to the projected pattern of balance of payments imbalances and the potential demand for use of Fund resources. In practice, the Fund has generally borrowed to finance the operations of newly established facilities, such as the Oil Facilities in 1974 and 1975, the Supplementary Financing Facility in 1979-81, and the enlarged access policy of 1981-86. While the Fund's approach to borrowing has evolved over time, a number of financial and operational issues have arisen on each occasion, albeit with different emphasis in different circumstances. These issues are addressed in the following paragraphs.

1. Sources of borrowing

The Fund so far has borrowed only from official sources and overwhelmingly from members or their monetary authorities. 2/ Although borrowing by the Fund in the private capital markets is permitted by the Articles of Agreement and has been considered on several occasions, it has not been pursued. Borrowing from official sources has the advantage that these lenders are very familiar with the particular needs of the Fund and its operational features, and there is by now a substantial body of experience with such borrowing.

1/ Article VII, Section I of the Articles of Agreement authorizes the Fund, if it deems such action appropriate to replenish its holdings of any member's currency in the General Resources Account, to:

> "... propose to the member that, on terms and conditions agreed between the Fund and the member, the latter lend its currency to the Fund or that, with the concurrence of the member, the Fund borrow such currency from some other source either within or outside the territories of the member ..."

2/ Exceptions are borrowing from Switzerland before it became a member and from the Bank for International Settlements (BIS).

2. Denomination of borrowing

Since 1972 members' indebtedness to the Fund has been denominated in SDRs. To avoid exchange risks, the Fund has therefore taken the position that its borrowing should likewise be denominated in SDRs (or it should borrow the currencies included in the SDR basket in proportion to their weight in that basket). As the method of valuing the SDR is decided by the Fund from time to time, creditors have been concerned about the possibility of a change in valuation. Generally, these concerns have been met by provisions that allow the lender to retain the former method of valuation in the event of a change, and at the same time give an option to the Fund, if the lender exercises its option, to make immediate repayment.

3. *Media of payment*

While Fund borrowing since the 1970s has been denominated in SDRs, the actual media of borrowing and repayment have been currencies, since the Fund may not borrow SDRs. In most bilateral borrowing agreements, the lender has provided either U.S. dollars or its own currency, or has undertaken to make arrangements to convert its own currency into a freely usable currency (typically U.S. dollars) as needed by the Fund. 1/ For repayment, the Fund has usually sought to provide maximum flexibility in the borrowing agreement, but on occasion lenders have wished to ensure that repayment would be made in currencies of their choice, normally their own currency or U.S. dollars.

4. Maturities

When relying on borrowed resources to finance drawings, the Fund has sought to borrow for the exact time period of use of Fund resources. In its borrowing for the two Oil Facilities and the Supplementary Financing Facility, the Fund borrowed when currency was needed for a purchase and repaid when the corresponding repurchases were made. This "pass-through" technique allows the maturities of liabilities to match those of the corresponding Fund assets. It was not possible to achieve such close matching under the borrowing agreements established for the enlarged access policy, as some borrowing from central banks could be arranged only at the relatively short end of the maturity range, reflecting the asset management preferences of that group of lenders. The consequent "mismatch" of maturities led to the establishment of the Borrowed Resources Suspense Accounts within the General Resources Account, as a means of holding and investing temporarily currencies not needed for immediate use in financing purchases under the policy on enlarged access.

1/ Borrowing of currency other than the creditor member's own currency requires the consent of the member issuing the currency.

5. Liquidity and transferability

Fund borrowing agreements have consistently provided for encashability at face value upon representation of a balance of payments need, with the further stipulation that the Fund would give such representation the overwhelming benefit of any doubt. As a consequence, a member's lending to the Fund can be regarded as a liquid reserve asset and held as part of its official reserves. In addition, claims on the Fund normally are transferable to other official holders (on terms agreed between the parties concerned). This provides some protection to the Fund's own liquidity, which was strengthened in the Supplementary Financing Facility (SFF) and later borrowing arrangements by restricting the transferability of claims to a recipient that, at the time of transfer, is in a relatively strong balance of payments and reserves position. Reflecting interest on the part of lenders in a further strengthening of the liquidity and marketability of claims in the early 1980s, provision was included in the borrowing agreements for enlarged access with SAMA for bearer notes to be issued by the Fund that could be sold by the lender to willing buyers at a mutually agreed price, including private holders. As described below, the encashability of such notes was somewhat more restrictive than the original loan claims and, in the event, the option was not exercised.

6. Interest rates

The costs to the Fund of borrowing have evolved over time, as have the charges levied by the Fund on purchases financed with borrowed resources. Prior to the borrowing for the Oil Facilities, i.e., under the GAB or a GAB-type arrangement, such as the borrowing of lire in 1966 (see below), the interest rates paid by the Fund were very low, reflecting the cooperative nature of the Fund and the fact that the cost of resources to the Fund was not based on the returns available in national or international markets; charges were also low reflecting considerations other than the cost of resources. 1/ However, the First Amendment of the Articles of Agreement in 1969 introduced the concept of remuneration, and members began to pay increased attention to the rate of return on their reserves made available to the Fund. Market rates were increasingly seen by lenders as measures of the "opportunity cost" of lending to the Fund. The early borrowing arrangements (e.g., in connection with the 1974 and 1975 Oil Facilities) paid interest at a fixed rate. In line with market practice, the Fund subsequently moved toward offering a floating rate, the first instance of which was in the 1977 loan agreements to finance the SFF. To protect the Fund's income position, the cost of borrowing, plus a small margin, has been

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1/ The schedule of charges on the use of Fund resources initially was intended to make prolonged use of Fund resources unattractive, in addition to covering the Fund's administration costs. The need to cover operational costs has arisen only subsequent to the First Amendment of the Fund's Articles in 1969.

reflected in the rate of charge applied to the use of borrowed resources, in some cases adjusted every six months. 1/

III. The Fund's Experience of Borrowing

This section describes chronologically the different instances of borrowing by the Fund, including the main considerations and the particular circumstances of the world economy at the time.

1. Ad hoc bilateral borrowing

The first instance of borrowing by the Fund was the establishment of the GAB in 1962, as described in EBS/95/117. The GAB are a borrowing arrangement in effect for a fixed period, but which may be renewed and in fact have been renewed. The Fund has on occasion also engaged in bilateral borrowing from individual official sources.

a. Borrowing from Italy (1966)

The first occasion on which the Fund borrowed bilaterally from a member was when it borrowed from Italy in 1966. Italy was running a sizable balance of payments surplus at the time and held large reserves holdings which it wished to lend ("deposit") to the Fund. Accordingly, Italy lent the Fund the lire equivalent of US$250 million, and the United States made a drawing in its gold tranche (what is now the reserve tranche) of US$250 million in lire, which it used to purchase US$250 million in U.S. dollars from Italy. These operations resulted in Italy acquiring a gold-guaranteed loan claim on the Fund, while the United States had a corresponding reduction in its gold (reserve) tranche position. This may be regarded as an early example of the substitution of assets through the effective intermediation of the Fund.

When this borrowing arrangement was discussed in the Executive Board, most Directors welcomed it as a useful innovation and example of international financial cooperation. The arrangement was structured in terms very similar to borrowing under the original provisions of the GAB

1/ On two occasions--for the 1975 Oil Facility and for the SFF--a subsidy has been provided to reduce the cost of borrowing from the Fund for eligible low-income members. Following the full drawdown of resources available under the related borrowing agreements and the expiration of the policy on enlarged access, the rate of charge on the use of ordinary and borrowed resources was unified effective May 1, 1993. See *Simplification of the Fund's Charges* (EBS/92/184, 11/20/92) and Executive Board Decision No. 10224-(92/147), adopted December 9, 1992.

decision. 1/ The loan was for five years' maturity, with a charge of 1/2 percent of the loan amount and interest at 1 1/2 percent (subject to adjustment in the event of a change in the rate of charge levied by the Fund on the use of its resources). Repayment was to be made in lire, gold, or, after consultation with Italy, in convertible currencies. In the event that Italy represented that it had a balance of payments need for early repayment, the Fund would give that representation the overwhelming benefit of any doubt. Italy could transfer its claim with the prior consent of the Fund. The transfer provision of the arrangement was activated in 1970 when the loan still had about a year to run; at that time Italy transferred its claim on the Fund to Japan.

b. General consideration of bilateral borrowing

Issues connected with borrowing by the Fund from its members in circumstances other than those for which the GAB had been established were more fully explored in 1969. At that time the staff suggested that in the light of fluctuations in the Fund's liquidity position and the possibility that the Fund's ability to meet members' requests for financial assistance could be put under strain, it would be useful to develop some general principles for bilateral borrowing of currencies in order that the Fund be in a position to act promptly should the need arise. 2/ While bilateral borrowing was not intended as a substitute for a quota increase, it "would be a form of insurance that would increase confidence in the Fund's ability to meet the needs of members."

The staff paper suggested for consideration some broad characteristics that might be included in bilateral arrangements of a stand-by character. These included the terms of borrowing; the conditions in which an arrangement could be activated; and a provision for early repayment to the lender upon representation of a balance of payments need. The Executive Board concluded that bilateral stand-by borrowing arrangements would be a useful mechanism to supplement the Fund's liquidity when the need arose, and that they could also encourage members in a strong balance of payments and reserves position to hold a part of their reserves in the form of claims on the Fund. On balance, while the Board did not object in principle to bilateral borrowing, it was considered premature to reach a general decision on the matter at that time. 3/ The issue of a generalized system of bilateral borrowing arrangements by the Fund was also considered in 1980-81, as discussed below.

1/ The text of the arrangement, which was approved by the Executive Board at EBM/66/66, is contained in *Fund Borrowing of Lire* (EBS/66/167, 7/25/66).
2/ See *Bilateral Borrowing* (SM/69/18, 2/7/69), discussed at EBM/69/33 (5/23/69). A particular factor at the time was the prospective entry into effect of the First Amendment to the Articles, following which members' requests for gold tranche purchases would no longer be subject to challenge.
3/ EBM/69/33 (5/23/69).

c. Borrowing from Switzerland (1977)

The next instances of bilateral borrowing by the Fund--from Switzerland--took place in 1977. The Swiss National Bank made available to the Fund the equivalent of SDR 300 million and SDR 37.5 million in U.S. dollars, under two loan agreements in connection with stand-by arrangements with the United Kingdom and with Italy, respectively. Like the borrowing from Italy in 1966, these borrowing agreements were on a bilateral basis outside the GAB. While many of the provisions of the agreements were similar to those under the GAB, they differed in the sense that these loans were "at call," i.e., the Swiss National Bank was obligated under the agreements to lend if the Fund made a call. In the event, neither of the amounts under the agreements was drawn in full. 1/

2. 1974 and 1975 Oil Facilities

a. 1974 Oil Facility

The sharp rise in world oil prices during 1973 presented oil importing countries with major problems of adjustment. In the circumstances, the Managing Director proposed that a facility be established in the Fund for the purpose of financing the balance of payments deficits arising from the oil crisis in such a way as to encourage members to adjust without resort to measures that would be detrimental to domestic and international prosperity.

1/ Other differences with the GAB included the SDR denomination of the bilateral loans (and consequent provision for retention of the former SDR valuation in case of a change), and a provision that in the event of early repayment the rate of interest on the amount repaid would be reduced by 1/2 percent. See (for the United Kingdom) *Swiss National Bank: Proposed Borrowing Agreement* (EBS/76/525, 12/20/76) and (for Italy) *Swiss National Bank: Proposed Borrowing Agreement* (EBS/77/117, 4/19/77). See also Executive Board Decisions No. 5288-(76/167), adopted December 22, 1976, and 5387-(77/61), adopted April 25, 1977. See Decisions No. 5306-(77/2), adopted January 3, 1977; 5531-(77/15), adopted January 31, 1977; and 5488-(77/116), adopted August 1, 1977, concerning the media in which the Fund was to pay interest and transfer charges.

It was envisaged that such a facility would be of a temporary nature and deal with a problem of transition. 1/

A review of the Fund's liquidity indicated that up to about SDR 5 billion in net drawings could be financed without major strain through use of the Fund's existing holdings of members' currencies. However, uncertainties surrounding potential drawings, including possible use of resources by members with large quotas, suggested maintaining the resources of the General Resources Account (GRA) for regular operations and consideration of borrowing as a supplement to the Fund's ordinary resources.

Negotiations between Fund management and prospective lenders began in early 1974 and soon centered on the rate of interest to be paid by the Fund. Potential lenders were not prepared to provide funds at other than essentially market rates, which substantially exceeded the then obtaining cost of GRA resources to the Fund. This clearly had implications for the rate of charge under the proposed facility. Accordingly, it was agreed that purchases under the Oil Facility would be subject to a separate schedule of charges. 2/ Charges on use of resources under the Facility were set according to a schedule that would average 7 percent a year, as shown in the table below, in order to meet the objective of making the Facility a "self-financing operation." It was, however, recognized that charges at market rates would pose a heavy burden for the most seriously affected developing countries, and it was suggested that ways to reduce the cost of borrowing under the Facility by low-income members be examined. 3/

1/ On the issues related to the borrowing arrangements, see *Borrowing by the Fund in Connection with the Oil Facility* (EBS/74/63, 3/8/74) and the minutes of EBM/74/20 and 74/21 (3/18/74). For details on other aspects of the proposed facility, including the formula for access, assessment of balance of payments need, conditionality, and rates of charge, see *A Facility to Assist Members in Meeting the Initial Impact of the Increase in Oil Import Costs* (SM/74/41, 2/19/74, and Sup. 1, 3/19/74, and EBS/74/45, 2/19/74). See also *Application of Revised Rates of Charges on Fund's Holdings in Excess of Quota* (SM/74/46, 2/21/74), *Uniformity in Relation to Charges* (SM/74/47, 2/21/74), *The Prospective Liquidity of the General Account* (EBS/74/53, 2/26/74), and the minutes of EBM/74/15 and 74/16 (3/8/74) and 74/17 (3/11/74).

2/ The question of the rate of charge to be applied to use of Fund resources under the Oil Facility was a complex one, impinging on broader interest rate issues in the Fund. See *Interrelationship of Charges, Remuneration, Interest on Borrowing, and Charges and Interest on Allocations and Holdings of SDRs* (SM/74/62, 3/19/74); *Charges: Classes of Members and Absolute Amounts* (SM/74/63, 3/20/74); *Application of Revised Rates of Charges on Fund's Holdings in Excess of Quota* (SM/74/46, 2/21/74); and *Uniformity in Relation to Charges* (SM/74/47, 2/21/74). See also the minutes of EBM/74/26 (3/25/74).

3/ In the event, a subsidy account was established in connection with the second (1975) Oil Facility (see below).

Table 1. Charges Under the 1974 Oil Facility

(In percent) 1/

Service charge	0.5
Up to 3 years	6.875
3 to 4 years	7.000
5 to 7 years	7.125

1/ In percent a year, except for service charge, which was payable once per transaction and was expressed as a percentage of the amount of the transaction.

During the period in which the Oil Facility was being considered, the Fund also discussed the valuation of and the rate of interest on the SDR. From July 1, 1974 the SDR would be valued on the basis of a standard basket, which was to be reviewed after two years. 1/ An issue of potential concern to creditors to the Oil Facility that arose in this context was the possibility of a change in valuation arising either from a discontinuous change in the value of the SDR in terms of all currencies, or from the transition to a different type of basket. It was agreed that the borrowing agreements for the Oil Facility would contain a provision whereby in the event of such a change, the lender would have the option to request that the loan continue to be denominated in an unchanged basket of currencies. The Fund for its part would have the option either to accept the attendant exchange risk or to repay the loan. This subsequently became an important standard feature of Fund borrowing agreements with members.

With the establishment of the Facility 2/ and the decision regarding borrowing in connection with the Facility, 3/ a standard draft borrowing agreement was approved, with the provision that the terms and conditions of individual borrowing agreements could be adapted for good reason, such as domestic legal requirements or the character of the lending institution. The loans were to be denominated in SDRs, with the resources provided in U.S. dollars or in the member's own currency. The Fund undertook to consult with the lender in order to agree on the medium in which payment of interest and repayment would be made; if agreement were not reached, the Fund would have the option to determine the medium, which could be the currency of the

1/ Executive Board Decision No. 4233-(74/67)S, adopted June 13, 1974.
2/ Executive Board Decision No. 4241-(74/67), adopted June 13, 1974.
3/ Executive Board Decision No. 4242-(74/67), adopted June 13, 1974.

lender, the currency borrowed, or either/both U.S. dollars and SDRs. Repayment would take place in eight equal installments beginning three years, and ending not later than seven years, after the date of transfer of the funds to the Fund, and interest would be paid quarterly at the rate of seven percent per annum. 1/ In order to maintain a neutral effect of the borrowings on the Fund's holdings of members' currencies, early repayment by the Fund would be permissible in the event of early repurchases of drawings. Part or all of repayments due could be made upon representation of a balance of payments need by the lender. As in earlier and subsequent borrowing arrangements, the Fund undertook to give such representation the overwhelming benefit of any doubt, thus providing a degree of liquidity of the lender's claim on the Fund comparable to a reserve tranche position. While the final loan agreements varied somewhat, for the most part they adhered closely to the "model." 2/

The Executive Board approved individual borrowing agreements providing total financing for the Facility of just over SDR 3 billion as indicated in Table 2 below.

Table 2. Lenders for the 1974 Oil Facility

	Amount (SDR millions)
Abu Dhabi	100
Canada	250
Central Bank of Iran	580
Central Bank of Kuwait	400
Netherlands	150
Nigeria	100
Oman Currency Board	20
Saudi Arabian Monetary Agency	1,000
Central Bank of Venezuela	450
Total	3,050

The first Oil Facility began operations in September 1974. Under this Facility, 41 members drew a total of SDR 2.6 billion. The majority of these members were developing countries--only one industrial country (Italy)

1/ These repayment and interest terms differed slightly from the terms on Fund lending to members under the Facility.

2/ The loan by Canada, for example, was for a term of five years, reflecting domestic legal constraints on lending for a longer period, and repayment was to be made in a lump sum at the end of the five years. Also, there were variations among the agreements with respect to the media to be used for repayment.

borrowed under the 1974 Facility, while six members classified at that time as developed primary producing countries also borrowed. 1/

b. 1975 Oil Facility

While it had taken longer than initially hoped to establish the 1974 Oil Facility, once it became operational, disbursements proceeded rapidly. However, it was becoming apparent that the balance of payments deficits of many countries arising from the "oil shock" and the accompanying recession in the world economy would persist well into 1975 and that financing mechanisms to deal with these deficits would need to be strengthened. At the same time, there was concern that the recycling process through the commercial banking system might carry undue risks and that therefore official channels should play a larger role.

At the Annual Meetings in September 1974, the Managing Director proposed that a further Oil Facility be established for 1975, stressing that it should be available to both industrial and developing members. He also noted the particular difficulties faced by the poorer countries in financing their deficits at market-related rates of interest. The suggestion for a larger Oil Facility was addressed in the first meeting of the Interim Committee in October 1974, which asked the Executive Board to "consider ... as a matter of urgency, the adequacy of existing private and official financing arrangements, and to report on the possible need for additional arrangements, including enlarged financing arrangements through the Fund, and to make proposals for dealing with the problem [of recycling]." 2/

The Executive Board took up the matter in late 1974 on the basis of papers by the staff which estimated that a Facility of about SDR 6-8 billion would be needed. 3/ In December 1974 the Board recommended to the Interim Committee that an Oil Facility be established for 1975. This proposal was subsequently endorsed by the Interim Committee, which considered that the size of the Facility should be up to SDR 5 billion financed through borrowing agreements, plus any unused amounts under the 1974 Facility.

The Executive Board also considered in this context a number of issues related to borrowing from non-official sources. This was the first time that the possibility of borrowing in the private markets had been raised in the Fund, reflecting concerns that the Fund might not be able to borrow

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1/ Greece, Iceland, New Zealand, Spain, Turkey, and the former Yugoslavia.

2/ Communiqué of Interim Committee, October 3, 1974.

3/ See *The Need for, and Possible Features of, a 1975 Oil Facility in the Fund* (SM/74/249, 11/11/74), *Adequacy of Present Financing Arrangements for the Recycling of Oil Surplus Funds* (SM/74/250, 11/13/74), and *Borrowing in Connection with the Oil Facility for 1975* (SM/74/259, 11/29/74). See also the minutes of EBM/74/146 and 74/147 (11/18/74), EBM/74/154 (12/6/74), and EBM/74/155 (12/9/74).

sufficient resources from official lenders. It was also argued by some officials and observers that borrowing in the markets by international governmental institutions would lend stability to the private recycling process. While a number of Directors supported the idea of borrowing by the Fund in the private markets, that view was not generally accepted, and the Board's report to the Interim Committee stated:

" ... The Executive Directors have given preliminary consideration to the possibility of the Fund borrowing from private sources; they have reached no conclusion on the desirability of such borrowing but they have agreed to continue further exploration of this subject."

In reviewing issues related to the terms and conditions of borrowing from official sources, the staff suggested the possibility of a change with respect to the provisions on early repayment, in particular the clause which provided that in the event of a change in the valuation of the SDR, the Fund was entitled, under certain circumstances, to repay outstanding balances under loan agreements. The staff suggested that consideration be given to two alternatives, of which the first was preferred, namely: (i) that the option for the lender to retain the prior method of valuation be dropped, or (ii) that the Fund, as well as the lender, have the option to retain the previous method of valuation on the occasion of a change. As it turned out, the lenders to the 1975 Oil Facility were satisfied with and were unwilling to change the options that had been available to them and to the Fund under the 1974 agreements with respect to the possibility of a change in the valuation of the SDR. 1/

Borrowing for the 1975 Facility was on a much broader basis than for the 1974 Facility. Agreements for new loans totaling SDR 3.9 billion were reached with seven 2/ of the nine members that had lent to the 1974 Facility, and additional borrowing arrangements were concluded with six European countries or their central banks, 3/ and with the Central Bank of Trinidad and Tobago (see Table 3 below).

1/ See the statement by the Managing Director at EBM/75/21 (2/24/75) reporting to the Executive Board on his recent discussions with potential lenders to the 1975 Facility.

2/ Iran, Kuwait, the Netherlands, Nigeria, Oman, Saudi Arabia, and Venezuela. Canada and the United Arab Emirates did not lend to the 1975 Facility.

3/ Austria, Belgium, Germany, Norway, Sweden, and Switzerland. (The Government of Switzerland and the Swiss National Bank lent separately.)

Table 3. Lenders for the 1975 Oil Facility

	Amount (SDR millions)
Austrian National Bank	100.0
National Bank of Belgium	200.0
Deutsche Bundesbank	600.0
Central Bank of Iran	410.0
Central Bank of Kuwait	285.0
Netherlands	200.0
Central Bank of Nigeria	200.0
Bank of Norway	100.0
Central Bank of Oman	0.5
Saudi Arabian Monetary Agency	1,250.0
Sveriges Riksbank	50.0
Swiss National Bank	100.0
Switzerland	150.0
Central Bank of Trinidad and Tobago	10.0
Central Bank of Venezuela	200.0
Total	3,855.5

The provisions of these borrowing arrangements were very similar to those for the 1974 Facility, the main differences being the extension of the commitment period from December 31, 1975 to March 31, 1976, 1/ and an increase in the rate of interest paid on the loans from 7 percent to 7 1/4 percent. The amount of these agreements was SDR 3.86 billion, so that even with the SDR 464 million carried over from the 1974 Facility, the total fell somewhat short of the SDR 5 billion target set by the Interim Committee. By the time the Facility was ended in May 1976, the full amount available had been drawn. Two industrial country members (Italy and the United Kingdom), eight developed primary producing members, and 36 developing members made use of the 1975 Facility.

The relatively high charges on use of the Oil Facility compared with the charges on use of the Fund's ordinary resources (reflecting the cost of borrowed funds) was a matter of concern. 2/ During the discussions on the 1975 Facility, substantial further interest was expressed in finding a means of reducing these charges. As a result, in the course of 1975 the Managing

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1/ It was later extended further to May 31, 1976. See Executive Board Decisions No. 4635-(75/47), adopted April 4, 1975, and 4916-(75/208), adopted December 24, 1975.

2/ The schedule of charges on drawings was raised by 0.75 percent compared with the 1974 Facility (see Table 1, page 9 above), reflecting that the average rate of interest paid to creditors also increased.

Director sought contributions from members which could be used to fund a Subsidy Account. The Subsidy Account was established in August 1975. 1/

3. Supplementary Financing Facility (SFF)

Toward the end of 1976 and in early 1977, it was expected that, given the persistence of large payments imbalances, there would be a continued need for substantial adjustment on the part of deficit countries and that, accordingly, heavy demands for use of the Fund's resources might well arise. 2/ In this context, the Managing Director suggested that expansion of the Fund's capacity to provide financial assistance subject to appropriate conditionality, beyond what could be expected to be financed from the Fund's ordinary resources, could contribute significantly to the promotion of international adjustment and to maintenance of confidence in the international monetary system, and he therefore proposed that the Fund borrow from members in strong balance of payments and reserves positions to finance such expansion. 3/

The Executive Board reached agreement relatively quickly that the Fund should establish what was termed the Supplementary Financing Facility. 4/ Unlike the use of resources under the two Oil Facilities, it was envisaged that supplementary financing would be provided in conjunction with the use of the Fund's ordinary resources to members facing payments imbalances that were large in relation to their quotas.

In August 1977 the Managing Director invited potential creditors to the facility to meet in Paris. The discussion at that meeting suggested that financing of about SDR 8.5 billion would be forthcoming, some of which had still to be confirmed by domestic legislative or executive bodies. Participants in the meeting also agreed on the interest rate to be offered to lenders--7 percent until June 30, 1978 and, for each six-month period thereafter, the average yield for the period on five-year U.S. Government securities (rounded up to the nearest 1/8 percent), which was considered consistent with the medium-term nature of the commitments by lenders.

1/ See *A Subsidy Account for Most Seriously Affected Countries Drawing Under the 1975 Oil Facility* (SM/75/40, 2/10/75), and *Subsidy Account* (SM/75/197, 7/23/75), and Sup. 1 (8/1/75). Twenty-four Fund members plus Switzerland contributed a total of SDR 160.3 million to the Account, which, taking into account also investment income of the Account, enabled subsidies totaling SDR 186.8 million to be paid to 25 eligible members.

2/ At this time, it remained uncertain when the increase in quotas under the Sixth General Review, which was linked to the entry into effect of the Second Amendment, would itself enter into effect.

3/ See *The Fund's Future Role in the Financing of Payments Imbalances: The Provision of Supplementary Credit and Fund Borrowing* (EBS/77/88, 3/30/77). See also *The Adequacy of International Liquidity* (SM/77/62, 3/21/77).

4/ A target of the order of SDR 14 billion was initially suggested for the size of the Facility, which figure was later revised to about SDR 8.5 billion.

The terms of the loans were to be similar to those of the loans provided for the Oil Facilities, with repayment to be made in eight equal installments beginning 3 1/2 years and ending not later than seven years after a call by the Fund, thereby matching the schedule of repurchases of members using supplementary resources. The liquidity of the claims on the Fund was enhanced by provision for the transferability of claims--either to any other lender on the basis of value agreed between the transferor and the transferee, or, with the prior consent of the Fund, to other transferees on terms and conditions prescribed by the Fund.

Decisions providing for the establishment of the facility and approving the text of a "standard" draft borrowing agreement were approved by the Executive Board later in August 1977. 1/ The former decision provided that the Supplementary Financing Facility would enter into effect on the date on which borrowing agreements were completed for resources of not less than SDR 7.75 billion, including at least six agreements each for an amount of not less than SDR 500 million. Reflecting this provision, the SFF did not become operational until February 23, 1979.

The final list of creditors and the amounts committed were as set out in the following table.

Table 4. Lenders for the Supplementary Financing Facility

	Amount (SDR millions)
Abu Dhabi	150
Austrian National Bank	50
National Bank of Belgium	150
Canada	200
Deutsche Bundesbank	1,050
Banco de Guatemala	30
Japan	900
Central Bank of Kuwait	400
The Netherlands Bank	100
Nigeria	220
Saudi Arabia Monetary Agency	1,934
Swiss National Bank	650
United States	1,450
Central Bank of Venezuela	500
Total	7,784

1/ Decisions No. 5508-(77/127) and 5509-(77/127), adopted August 29, 1977.

4. Enlarged access

In the early 1980s, in the context of the policy on enlarged access to Fund resources, the Fund entered into a series of borrowing arrangements with different characteristics and which involved the largest amount of borrowing to date, both in total and with respect to an individual lender. At this time the Fund gave renewed consideration to the possibility of borrowing in the private markets, but again did not pursue this course. 1/ The Fund also considered the possibility of borrowing by means of short-term placements with central banks. In a related development, the Fund established guidelines on borrowing which have been amended periodically in the light of changing circumstances and which now provide an important guide to the Fund's future policies on borrowing.

a. *Enlarged access--general issues related to borrowing*

Following the second sharp rise in oil prices in 1979-80, the external outlook for the non-oil developing countries worsened significantly. The ability of these countries to finance their balance of payments deficits, while pursuing appropriate adjustment policies, was a major issue facing the Fund. In particular, with increased strains on the commercial banking system and reduced access by the developing countries to the medium-term syndicated credit market, the Fund was called on to play a larger role as a financial intermediary in the "recycling" process. It was clear that the resources provided to the Fund under the SFF would be fully committed before long and in all likelihood well in advance of the next increase in quotas under the Eighth General Review. It was also clear that the current account surpluses were concentrated in a few countries with relatively small quotas, so that the addition to the Fund's usable resources provided by a general increase in quotas was likely to be fairly limited.

Against this background, the Fund developed the policy on enlarged access, which was specifically intended (like the SFF) to assist members facing serious payments imbalances that were large in relation to their quotas. It was decided that such access, which would be provided under a stand-by or an extended arrangement, would be financed through a combination of ordinary and borrowed resources. 2/ In their consideration of these issues in late 1980, the Executive Directors discussed not only the need for

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1/ Furthermore, during this period the GAB were extensively revised and enlarged.

2/ See Executive Board Decision No. 6783-(81/40), adopted March 11, 1981, which sets out, inter alia, the ratios of ordinary to borrowed resources that would apply in different circumstances.

Fund borrowing, but also the various potential sources of borrowing, including the private capital markets. 1/ 2/

In the paper on main issues with respect to borrowing (EBS/80/247), the staff discussed inter alia the various avenues of borrowing that were available to the Fund to finance enlarged access to Fund resources. The three main possibilities were: (i) borrowing arrangements with those few countries whose balance of payments positions were likely to remain strong for the foreseeable future and to give rise to a substantial accumulation of reserves. In the light of Executive Board guidance, these arrangements would be as far as possible on the traditional lines of Fund borrowing, with drawdowns matching purchases and repayments matching repurchases; (ii) bilateral borrowing arrangements that were more flexible and market-oriented than in the past. Since it could not be precluded that it would take some time before bilateral arrangements could be agreed, the staff suggested that options also be explored with central banks; and (iii) borrowing from the private capital markets. 3/ Developments on these various alternatives are set out in the following sections.

1/ At its September 1980 meeting, the Interim Committee had endorsed the principle of borrowing to supplement the Fund's resources in connection with the developing policy on enlarged access, and had indicated specifically: "In view of the magnitude of the expected need, the Committee agreed that the Executive Board and the Managing Director should make, as soon as possible, the necessary arrangements to enable the Fund to borrow from various potential sources of financing, not excluding a possible recourse to the private markets if this were indispensable."

2/ See *Borrowing by the Fund--Main Issues* (EBS/80/247, 11/12/80); *Legal and Procedural Aspects of Borrowing by the Fund in Capital Markets* (SM/80/258, 11/12/80); and *The Chairman's Summing Up of the Discussion at Executive Board Meeting 80/174, November 26, 1980* (BUFF 80/236, 11/28/80). See also *Financing of Enlarged Access to the Fund's Resources* (EBS/80/156, 7/14/80), and the discussion of that paper at EBM/80/114 and 80/115 (7/30/80).

3/ It was recognized that borrowing by the Fund (whether from official or private institutions) in maturities that did not match the purchase and repurchase schedules of Fund credit would require the development of modalities to manage the borrowed funds. These considerations led subsequently to the establishment of the Borrowed Resources Suspense Accounts. See *The Management of Borrowed Funds* (EBS/81/33, 2/11/81).

b. <u>Borrowing from the Saudi Arabian Monetary Agency (SAMA) (1981)</u>

Following the general discussion of borrowing options referred to above, the Fund proceeded to conclude with the Saudi Arabian Monetary Agency (SAMA) a borrowing agreement which was notable in a number of respects. 1/ It was the first agreement for the financing of enlarged access and by far the biggest, involving a commitment of SDR 4 billion in the first year (1981) and a further SDR 4 billion in the second year, and providing slightly more than half of the total borrowing in support of enlarged access. 2/ For its part, the Fund undertook to draw at least SDR 1 billion in the first year and not more than SDR 4 billion in any one year (without the further agreement of SAMA).

Reflecting in large part the preferences of the creditor, the agreement with SAMA represented in both its financial and legal aspects major innovations in Fund borrowing practice, bringing the Fund much closer than previously to a market-type agreement. It was a far more complex arrangement than any of the agreements between the Fund and lenders for the Oil Facilities and the SFF. 3/ Like earlier agreements, the loans 4/ were denominated in SDRs and it was provided that, if the Fund changed the valuation of the SDR, SAMA would have the option to require that all loans outstanding on the effective date of the change continue to be valued on the former basis. If this option were to be exercised, the Fund had the option to repay in full at 14 days' notice. The interest rate provisions were the

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1/ For the final text of the agreement and associated documentation, see *Borrowing Agreement with the Saudi Arabian Monetary Agency* (EBD/81/132, 5/8/81). See also *Borrowing Agreement with the Saudi Arabian Monetary Agency (SAMA)* (EBS/81/95, Sup. 1, 4/22/81).

2/ The agreement provided for a review of the commitment for the third year and expressed the Fund's hope that SAMA would at that time enter into a further commitment to bring the total to SDR 12 billion. In the event, SAMA provided a further SDR 3 billion in parallel with the further financing arranged with the BIS and central banks in 1984 (see below).

3/ The text of the agreement and its four annexes ran to 17 pages in the Fund's 1981 *Annual Report*. The annexes dealt with (a) the details of the computation of the interest rate; (b) the form of bearer notes with coupons; (c) a letter from the Managing Director to the Governor of SAMA indicating that he would be proposing shortly to the Executive Board a policy on guidelines on borrowing by the Fund; and (d) a memorandum by the Director of the Fund's Legal Department explaining why the Fund was legally bound to perform in good faith obligations under borrowing agreements and that no organ of the Fund should take action to nullify or evade such obligations.

4/ Each call by the Fund constituted a separate loan by SAMA, repayable by the Fund in four equal annual installments commencing four years after the call was made.

first in which an SDR-based interest rate was used in a Fund borrowing agreement. 1/

SAMA was entitled to request repayment in the event of a balance of payments need. However, in view of the size of the loans, it was agreed that the Fund's immediate repayment obligation would be limited to SDR 4 billion, with any balance outstanding to be repaid within 12 months. SAMA was also entitled to repayment of all loans if the Fund defaulted on any obligation under the agreement, or under arrangements with any other lender, and if the default persisted for 90 days.

With respect to transferability, the agreement contained some features found in previous Fund borrowing arrangements--such as the right to transfer to other official entities 2/--but there were also major innovations, including provision that SAMA had the right at any time to call on the Fund to provide promissory notes in bearer form in substitution for all or part of a loan. The notes would be transferable to any entity, official or private, would have the same maturity date as the corresponding loan, and would have interest coupons attached for each unexpired interest payment date. While the terms of the notes were generally similar to those of the loan, there were some important differences, designed to reflect the character of the notes as marketable instruments, which, in effect, gave SAMA the option to move from the official context of the loans to a commercial one. As it turned out, the provisions relating to the notes were not activated during the life of the agreement.

c. Short-term borrowing from the Bank for International Settlements (BIS) and central banks

The borrowing which the Fund undertook from the BIS and central banks was a further innovation in various respects. First, it involved a significant measure of maturity transformation, since the Fund was, in effect, borrowing short and lending long. Repayments would be made before the corresponding repurchases, so that in due course the Fund liquidity position would be adversely affected. Other Fund borrowing had either been conducted on a strictly "pass-through" basis, or had sought to match the maturity of loans reasonably closely to the schedule of Fund credit. Also, the approach to the BIS and the central banks, like the agreement with SAMA, had elements of a market orientation, such as the option for the central banks to obtain bearer notes.

1/ The rate, which would be adjusted at six-month intervals, was a combined one, computed on the basis of a weighted average of yields on five-year securities in the domestic markets of the currencies forming the SDR basket. The intention was that the currency components and weighing in the interest computation should always match those in the SDR basket.

2/ As in other agreements, encashability by the transferee applied only if, at the time of transfer, the transferee was a net creditor of the Fund and its currency was usable by the Fund.

The approach was seen as having several advantages: the Fund was well acquainted with the central banks (and vice versa), so there was not the extensive preparatory work, including of a procedural and legal nature, that would have been necessary if the Fund had approached the market. It was also considered that the interest terms might be more favorable than borrowing from the market. And while the problem of maturity transformation would exist, it was not considered likely to be a major hurdle since the central banks could be expected to roll over the loans, unless they experienced a major loss of reserves. It was, furthermore, a means of facilitating the investment of official monetary reserves with the Fund.

In August 1981 agreement was reached with the BIS and 16 central banks or official agencies of industrial countries that they would make available to the Fund the equivalent of SDR 1.3 billion over a commitment period of two years. 1/ Of this amount, SDR 675 million was provided by central banks through the BIS, and the balance borrowed by the Fund under direct bilateral arrangements with the National Bank of Belgium, Japan, the Swiss National Bank, and the Bank of England. The Fund also entered into separate arrangements with the Bank of Finland and the Reserve Bank of Australia. The arrangements with the central banks and official agencies were made on substantially the same terms as the agreement with the BIS, the main features of which were as follows: 2/

(1) The BIS opened, without fee, a stand-by facility for the Fund of SDR 675 million for a commitment period of two years from June 1, 1981, covering the amounts that participating central banks would make available through the BIS.

(2) The Fund could draw on the facility at seven business days' notice, with no restrictions on the maximum amount of an individual drawing, each of which constituted a loan with a nominal maturity of six months that could be renewed four times, effectively extending the maturity to up to two and one-half years, but the terminal date could not go beyond January 31, 1985.

(3) Drawings were denominated in SDRs, with the vehicle currency normally the U.S. dollar. Provision was made that if the Fund requested the BIS to make any payment in a currency other than the U.S. dollar, the BIS would do its best to meet the Fund's wishes.

1/ The 16 countries were Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Italy, Japan, the Netherlands, Norway, Spain, Sweden, Switzerland, and the United Kingdom. Shortly thereafter agreements were also reached with Ireland and South Africa.

2/ See *Borrowing by the Fund from the Bank for International Settlements (BIS) and from Central Banks and from Monetary Authorities* (SM/81/109, 5/12/81).

(4) The interest rate for each drawing and for each renewal was established on the basis of six-month rates on financial instruments of the currencies in the SDR basket, using the same method of calculation as used in the recently concluded SAMA agreement, with the result rounded upward, if necessary, to the nearest 1/16 per cent.

The bilateral agreements with individual central banks followed similar lines, it being basically a matter of individual preference by the central banks whether they lent directly to the Fund or through the BIS facility. In addition, similar to the terms of the arrangement with SAMA, lenders under bilateral arrangements could obtain, if they so wished, certificates of indebtedness, although--in contrast to SAMA--these certificates would not be negotiable. However, lenders could obtain bearer notes in exchange for their loan claims, which had to be requested within 10 days after a drawing or renewal. 1/

d. Placements with central banks

The Fund also gave consideration during 1980-81 to making short-term placements with central banks as an additional avenue of borrowing. Such a facility was seen as a potential source of resources that would supplement the Fund's borrowing under bilateral arrangements. It was felt that "it would ... be preferable if financial support for the Fund were to be provided by a wide range of Fund members. Furthermore, it would seem advisable that the Fund be in a position to draw on various sources of borrowing that would provide much more flexibility in meeting its financial needs. ... These avenues would not only provide additional resources but could also broaden participation of the Fund's membership in providing support to the Fund." 2/

It was envisaged that the Fund could place short-term paper with a wide range of central banks, not just those of countries in strong balance of payments positions. Such paper would have attractive characteristics for the investment of reserves by the central banks, and would be offered on a regular basis with the amounts reflecting the Fund's financing needs and the anticipated demand for such paper. The Executive Board considered this approach in November 1980 and concluded that the management and staff should pursue it in addition to seeking to arrange bilateral borrowing.

The staff's discussions with a number of central banks on this matter were reported to the Executive Board in November 1981. 3/ It was indicated that interest had been expressed in participating in such a

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1/ As in the SAMA agreement, the Fund agreed to waive its immunity from judicial process in respect of actions under the notes and to submit to the jurisdiction of courts in the State of New York.

2/ EBS/80/247, page 7.

3/ See *Borrowing by the Fund from Central Banks and Monetary Authorities - Range of Potential Lenders* (EBS/81/217, 11/2/81).

borrowing program (involving short-term placements by the Fund) not only by members considered to have balance of payments and reserves positions sufficiently strong for inclusion in the operational budget, but also by other members that had a need to invest their reserves. A major question raised by the staff was whether the Fund would wish to enter into a borrowing agreement with any member that was prepared to do so, including members that were indebted to the Fund, or whether there should be some restriction as to the range of members from which the Fund would be willing to borrow.

The staff concluded that a primary criterion for negotiating a borrowing agreement with the central bank of a member country would be the strength of the member's reserves position and, in particular, the size of the member's reserves and the likelihood that claims on the Fund arising under the agreement would be held reasonably firmly. This was to be a matter of judgment, taking a member's particular circumstances into account, including its willingness to invest part of its reserves in a Fund position. The fact that a member was indebted to the Fund, or had a current stand-by or extended arrangement, or that it was not included in the operational budget, would not necessarily stand in the way of borrowing from that member. The staff was also of the view that the existence of such a borrowing agreement would not affect a member's right to use Fund resources.

Although some Executive Directors expressed doubts, most indicated that they could go along with the thrust of the borrowing criteria set out in EBS/81/217. 1/ The Managing Director made clear that such borrowing would be intended to bridge the period until completion of the Eighth General Review of Quotas, in order to enable the Fund to meet its commitments under the policy on enlarged access. There were, however, continuing concerns among some Directors, in particular that the Fund should not borrow from debtors (including those using the Fund's resources), that the Fund might need to refuse some members' offers to lend, and that there were drawbacks for the Fund to borrowing on a relatively short-term basis and at market-related costs. In the event, the approach of placing paper with central banks was not implemented. The agreement with SAMA and the short-term borrowing agreements with the BIS and central banks had already been concluded in 1981, and the quota increase under the Eighth Review became effective in November 1983, so that there was a less pressing need to augment the Fund's borrowed resources than a few years earlier.

e. Borrowing in the private capital markets

Consideration was also given in the period from late 1980 to April 1983 to borrowing by the Fund in the private markets. In EBS/80/247 (11/12/80) the staff observed that in view of "the uncertainty on the amounts to be expected from the bilateral and central bank approaches, it would seem indispensable for market borrowing to be worked on in parallel with

1/ See the minutes of EBM/81/142 (11/16/81).

bilateral borrowing and placements with central banks. Market borrowing would enable the Fund to tap new sources of finance, and it may well attract additional amounts from those sources that provide finance through the first two avenues of borrowing." The staff followed up on the question of private market borrowing in a paper entitled *Borrowing by the Fund in the Private Market*, 1/ which set out reasons for and advantages of private market borrowing as well as techniques and policy issues.

The reasons for pursuing work on market borrowing were: (i) the general, though not unanimous, preference of Executive Directors to pursue all possible avenues of borrowing by the Fund; (ii) it was not possible to predict whether borrowing from official sources could be arranged on a sufficiently large scale to meet the demand for Fund resources under enlarged access for the full period foreseen; and (iii) apart from the need to raise resources, to establish for the Fund a name and presence in the market, create a secondary market for paper issued by the Fund to official lenders that would provide liquidity to the claims on the Fund (which was considered important by bilateral lenders), and develop the availability in the market of SDR-denominated funds which could be tapped by the Fund subsequently when it had large-scale financing needs. The staff also considered that the sale of short-term paper in the market might increase the finance available from official sources, in indirect lending through the markets or in forms that would retain that anonymity. Finally, the staff expressed the view that the Fund should borrow from the markets from a position of strength (i.e., borrow earlier rather than later), which would enlarge available financing and lessen fluctuations in the cost of borrowing.

In their discussions on private market borrowing through April 1983, 2/ several Executive Directors considered that the Fund should be prepared to move rapidly to market borrowing if necessary, while others regarded it as too early to take precise steps in that direction in view of the availability of official borrowing and the prospects for further borrowing from official sources. However, a number of Directors were opposed because, in their view, market borrowing would not be consistent with the cooperative character of the Fund, whose basic purpose was to facilitate the overall adjustment process by channeling surpluses to deficit countries; enlarged access was to be temporary and therefore borrowing by the Fund should also be temporary and was likely to be available from

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1/ EBS/81/65 (3/18/81).

2/ See the minutes of EBM/81/53 and 81/54 (4/10/81), the minutes of EBM/81/119 and 81/120 (9/4/81), and *The Chairman's Summing Up at the Conclusion of the Discussion on the Fund's Liquidity Position and Financing Needs, Guidelines on Borrowing by the Fund, and the Impact of Borrowing by the Fund* (BUFF/81/169, 9/10/81). See also the minutes of EBM/83/59 and 83/60 (4/8/83), and *The Chairman's Summing Up at the Conclusion of the Discussion on the Fund's Liquidity Position and Financing Needs* (BUFF/83/97, 4/14/83).

official sources to bridge to the completion of the Eighth General Quota Review; the Fund had no need to establish long-term borrowing arrangements through the market for this purpose; market borrowing could well be very costly, with negative consequences for the concessionality of Fund credit that might lead to a reluctance on the part of member countries to make use of Fund resources at existing levels of conditionality; and the Fund should not become an intermediary in market recycling.

The Managing Director in his summing up in April 1983 concluded that the matter would be left under review in light of the Fund's liquidity position as it evolved following the borrowing arrangements with SAMA and other official creditors. The staff would continue to work actively, but quietly, on the subject. In the event, the Executive Board did not return to any further substantive discussion of private market borrowing.

f. Further borrowing for enlarged access from the BIS and other official institutions (1984)

In early 1984, in the context of a review of enlarged access, it was concluded that the demand for Fund resources was likely to remain at a high level given the continued payments imbalances of a number of member countries, some of which faced structural difficulties that involved longer-run adjustment efforts. The Executive Board therefore decided to extend the policy on enlarged access to the end of 1984. 1/ It was considered appropriate that the Fund endeavor to strengthen its liquidity position by seeking renewed short-term funds from surplus countries, and accordingly agreements were negotiated with a number of industrial countries and with the BIS for a facility under which the Fund would be able to borrow up to SDR 3 billion. 2/ In parallel, an agreement for the same amount was negotiated with SAMA, supplementary to the agreement made in 1981. 3/

The agreement with the BIS was modeled generally on the 1981 agreement with that institution, but with a number of modifications to reflect two related elements desired by the lenders: (a) that the financial terms of the new agreement should more closely approximate those prevailing in international capital markets, and (b) that the BIS would provide the

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1/ Decision No. 7599-(84/3), adopted January 6, 1984. The decision provided also for annual reviews as long as it remained in effect. The policy on enlarged access lapsed on November 11, 1992.

2/ Of this SDR 3 billion, Japan and the National Bank of Belgium provided, respectively, SDR 375 million and SDR 120 million under bilateral loan agreements directly with the Fund and the balance of SDR 2,505 million was provided by the BIS, in part with the support of central banks and in part on its own account.

3/ For the final texts of all four agreements, which entered into effect together on April 30, 1984, see *Implementation of Borrowing Agreements* (EBS/84/97, 5/2/84).

financing from its general pool of resources, rather than through special deposits by participating central banks as under the 1981 agreement.

Unlike the 1981 agreement, the facility carried a stand-by commission of 1/4 percent to compensate the BIS for having to manage its liquidity in such a way that relatively large amounts could be drawn by the Fund at short notice. All drawings and repayments under the facility would be denominated in current SDRs. In contrast to earlier Fund borrowing agreements (including with the BIS in 1981), the lender did not request the right to opt for the former SDR valuation in the event of a change, and consequently there was no need for the Fund to have the option of early repayment if that right were exercised. All payments would be made in U.S. dollars (on a two-day value basis, the normal market practice), and could be made in SDRs or other currencies "at an agreed exchange rate." 1/ The interest rate would be the weighted average of offered rates for the SDR basket of currencies for the period of the relevant drawing or renewal--which would normally be three months, but could be longer by mutual agreement--rounded up to the next 1/8 percent. At the request of the BIS, a provision was included to specify that any questions arising under the facility would be settled by mutual agreement and not be governed by the municipal (i.e., domestic) law of any country.

The agreements made at the same time with Japan and the National Bank of Belgium were broadly similar to that with the BIS. Areas of difference included that no provision was made for a stand-by commission (which reflected the requirement of the BIS). Also, these agreements contained the by now standard provisions in Fund borrowing agreements with respect to the encashment of claims upon representation of a balance of payments need and the transferability of claims, and they contained the provision for continuation of valuation of claims on the basis of the "old" SDR in the event of a change in its valuation and the Fund's right to early repayment if that option were exercised. The commitment period under all three agreements was one year, which was subsequently extended in the light of delays in the expected use of Fund resources under some stand-by and extended arrangements. The agreements with the BIS and Japan were extended for eights months--i.e., until December 31, 1985--and that with Belgium until February 28, 1986. 2/

The agreement with SAMA, which, as noted, took the form of a supplement to the borrowing agreement of May 1981, reflected the interest rate and maturity conditions negotiated with lenders in the industrial group, but in

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1/ The reference to "an agreed exchange rate" reflected the fact that the Fund's official rates for currencies, calculated on the basis of representative exchange rates, were not fully consistent with the market exchange rates used to calculate the SDR rate and available to the BIS for operational purposes.

2/ Executive Board Decision No. 7955-(85/60), adopted April 23, 1985. See also EBS/85/95 (4/17/85).

other respects incorporated or was based on the terms of the 1981 agreement with SAMA. In the course of the negotiations with the staff, and at the Executive Board meeting at which all four loan agreements were approved, the Saudi Arabian authorities expressed concern about developments they considered had the potential to create difficulties with respect to preserving the financial integrity and strength of the Fund in the years ahead. In particular, they were strongly concerned that any deterioration of the Fund's financial position would be seriously aggravated if the Fund were to consider reducing its holdings of gold. In response, the Executive Board took careful note of the concerns of the Saudi Arabian authorities, including the importance they attached to the Fund's holdings of gold. The Board confirmed that, in the event that the Fund were seriously to contemplate a material reduction in the amount of its gold holdings without having taken such steps as might be necessary to ensure its continued ability to meet its obligations to its creditors, the Board would consider fully and in good faith any request that might be received from SAMA for early repayment under paragraph 9(b) of SAMA's lending agreement with the Fund. 1/

5. Borrowing from Japan (1986)

At the Annual Meetings in September 1986, the Minister of Finance of Japan announced an offer by the Government of Japan to lend the equivalent of SDR 3 billion to the Fund, with the intention to strengthen the financial position of the Fund and to facilitate a flexible response in accordance with Fund policies to assist members to overcome balance of payments difficulties, in light of the severity of such difficulties confronting or in prospect for many members in the period ahead. Negotiations leading to a borrowing agreement were essentially concluded by November 1986, with the agreement approved by the Executive Board in December of that year. 2/

The terms of the agreement were modeled in certain respects on the 1984 agreement between the Fund and Japan, but in other areas, particularly relating to the drawdown period, maturity, and interest, the agreement more closely resembled some of the pre-1984 borrowing agreements.

The main features of the agreement were as follows 3/:

1/ See the minutes of EBM/84/64 (4/24/84).

2/ Decision No. 8486-(86/205), adopted December 19, 1986. For the text of the agreement, see *Borrowing by the Fund from the Government of Japan* (EBS/86/265, 11/25/86).

3/ The other provisions were those customary in Fund borrowing agreements with members--termination of drawings or encashment of claims on representation of a balance of payments need; denomination in SDRs, with the option for the lender to retain the old valuation should there be a change and for the Fund to make early repayment if that option were exercised; Japan could request non-negotiable certificates evidencing its claim on the Fund; and any questions would be settled by mutual agreement.

a. The amount--SDR 3 billion--could be drawn by the Fund over a period of four years, with provision for a further two-year extension in light of the Fund's liquidity and prospective borrowing requirements.

b. The Fund would seek to draw--on three days' notice--not more than SDR 400 million at any one time and not more than SDR 800 million in one week. The short notice period was expected to minimize the need for investment of drawdowns pending their use in purchases, but if needed funds would be held in the Borrowed Resources Suspense Accounts. Drawings would be in yen, with arrangements for exchange into U.S. dollars to the extent required by the Fund.

c. Individual drawings would be for six months, renewable at the option of the Fund, with a final maturity of five years from the date of the drawing. This approximated the average maturity of purchases under the enlarged access policy, and the Fund would have the ability to repay earlier (e.g., to match an earlier repurchase).

d. Interest would be based on the combined domestic rate for six-month maturities of the currencies in the SDR basket. Payments of interest and principal would normally be made in yen, with provision for agreement on other currencies or, failing agreement, the Fund could select the media.

Proposals for incorporating the Japanese financing into the Fund's lending operations were discussed in a separate paper considered by the Executive Board at the same time as the loan agreement. 1/ Directors supported an approach whereby the loan would be used to finance purchases under stand-by and extended arrangements approved in accordance with the enlarged access policy. At the same time, the mix of ordinary and borrowed resources under the enlarged access policy was changed from 1:1 to 1:2 (i.e., the proportion of borrowed resources was increased from one-half to two-thirds).

6. Guidelines on Borrowing (1982-91)

In connection with the 1981 borrowing agreement with SAMA, the Managing Director undertook to develop guidelines that would place borrowing by the Fund in a framework aimed at strengthening the security of resources that member countries made available to the Fund. These guidelines were intended not only to meet the express concerns of lenders, but also the concerns of a number of Executive Directors (representing both creditor and debtor members) in establishing guidelines regarding what could be considered a

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1/ See *Management of the Fund's Liquidity in Connection with the Borrowing Agreement with Japan and the Extension of Drawdown Periods Under the Borrowing Agreements with the Saudi Arabian Monetary Agency (SAMA)* (EBS/86/266, 11/25/86). See also the minutes of EBM/86/204 and 86/205 (12/19/86).

reasonable limitation on the proportion of Fund resources derived from borrowing.

A staff paper on guidelines on borrowing was initially considered by the Executive Directors in August 1981, and after further discussions in January 1982, a decision on guidelines was adopted. 1/ These Guidelines incorporated several principles: that the Fund's financing should be predominantly assured through subscribed resources (quotas) rather than through borrowing; that borrowed resources should be relied upon only for temporary needs; and that the Fund's assets available to service its indebtedness should be sufficient to provide a safety margin for the Fund to be able to adjust to unforeseen circumstances. General as well as particular aspects of the Fund's assets were considered in this regard, including currencies, SDRs, and gold, and the role that each of these might play in the prudential management of the Fund's borrowing. The composition of the Fund's assets, including uncertainties with respect to their usability in particular circumstances, was seen to render particularly difficult the development of suitable asset ratios as a practical guideline for borrowing in the context of the Fund.

Taking these difficulties into account, the staff suggested that quotas offered a more stable criterion, and that limiting the total amount of borrowing (including unused credit lines) in relation to the total of quotas might provide a straightforward and suitable guideline. It would also give concrete expression to the view that quotas remained the basic source of financing for the Fund.

Over a series of discussions, Executive Directors stressed that quotas should remain the principal source of Fund financing and that, therefore, borrowing should only be of a supplementary or bridging nature. Concern was expressed that too relaxed an attitude toward borrowing might run counter to the urgency of securing a substantial increase in quotas under the Eight General Review. Initially, a number of Directors expressed preference for an approach whereby the Fund's liquidity and financing needs would be kept under continuous review, rather than the adoption of quantitative guidelines, which they considered might be too rigid for the Fund. However, over the course of the discussions, recognizing, in particular, the preferences of the Fund's major creditors, these Directors accepted that a specific borrowing limit could be useful. Directors also agreed that a quota ratio

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1/ Decision No. 7040-(82/7), adopted January 13, 1982. See *Guidelines on Borrowing by the Fund* (EBS/81/174, 8/19/81); *The Chairman's Summing Up of the Discussion* at EBM/81/120 (BUFF/81/169, 9/10/81); *Guidelines on Borrowing by the Fund: Further Considerations* (EBS/81/227, 11/24/81); *Guidelines on Borrowing by the Fund--Draft Decision* (EBS/81/227, Sup. 1, 1/12/82); and *The Chairman's Concluding Remarks* at EBM/82/7 (BUFF/82/4, 1/22/82). See also the minutes of EBM/81/119 and 81/120 (9/4/81), EBM/82/4 and 82/5 (1/11/82), and EBM/82/6 and 82/7 (1/13/82). The text of the amended Guidelines adopted in 1991 is set out in the Attachment.

was preferable to an asset ratio, and a consensus emerged around a range of 50-60 percent of quotas as the applicable guideline beyond which the Fund would not allow the total of outstanding borrowing plus unused credit lines to rise. In the Guidelines as adopted, provision was also made that when the total reached 50 percent of quotas, the Executive Board would assess the various technical factors determining the balances of unused credit lines. It was further stated that the Guidelines would be reviewed in case of major developments and, in any event, when the Eighth General Review of Quotas was completed, and that they might be adjusted as a result of such reviews. The Guidelines emphasized that the limits were not to be understood as targets for borrowing by the Fund.

When the Guidelines were first reviewed in 1983, following completion of the Eighth General Review and the major revision and enlargement of the GAB, the only amendments were to reflect the GAB revision and enlargement and to substitute the Ninth General Review of Quotas as the next "trigger" point for a review, with the addition that a review would also take place when there was "a significant change in the GAB or associated arrangements."

In 1991 the Guidelines were reviewed again, following the completion of the Ninth General Review and in the context of the consideration of access limits on the use of Fund resources in connection with the quota increase. 1/ At this time, all borrowing arrangements under the enlarged access policy had been exhausted and the drawdown periods had expired. The staff projected that in the absence of further recourse to borrowing--which was not envisaged, given the Fund's current and prospective liquidity position--the ratio of borrowing to quotas, as defined in the Guidelines (i.e., based on two-thirds of the total credit lines under the GAB), would stabilize by late 1995 at about 8.6 percent of (post-Ninth Review) quotas.

Reflecting the expectation that, following the completion of the Ninth Review and the prospective termination of the enlarged access policy, the Fund would rely largely on its ordinary resources to meet the demands for Fund credit, the staff proposed that the Guidelines on Borrowing be retained but further revised. The staff noted that the Guidelines had important general applicability that went beyond the context in which they had originally been drawn up. They gave specific content to the principle that quotas were the basic source of Fund financing as well as providing assurance to creditors of the Fund's prudent management of its resources. However, the limitation of borrowing to the range of 50 to 60 percent of quotas was no longer an effective operational guideline, and the staff suggested therefore that the Guidelines in this respect be recast to provide that, in advance of any future borrowing by the Fund, except in the case of

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1/ See *Review of the Fund's Liquidity and Financing Needs* (EBS/91/139, 8/20/91, and Sup. 1, 11/8/91). See also *Review of Access Policy and Limits in Connection with the Quota Increases - Preliminary Considerations* (EBS/91/152, 9/9/91), and the minutes of EBM/91/155 and 91/156 (11/15/91).

borrowing under the GAB, 1/ the Executive Board should establish in the context of the circumstances at the time borrowing limits expressed (as before) in terms of the total of Fund quotas. The amended Guidelines as proposed by the staff were adopted by the Executive Board. 2/ They remain in effect and would have to be reconsidered if the Fund were to undertake renewed borrowing outside of the GAB.

IV. Summary and Conclusions

The following are the main conclusions that can be drawn from the above discussion:

1. Quotas are the basic source of financing for the Fund's financial assistance to its members. However, borrowing from member countries, including borrowing outside of the GAB, has played an important supplementary role in providing resources to the Fund during certain periods, in particular during the period of large payments imbalances from the early 1970s to the mid-1980s, when borrowed resources financed some 40-60 percent of Fund credit. The heavy reliance on borrowing during that period reflected not only the relatively small increases in quotas under the Fifth and Sixth General Reviews, but also that the distribution of balance of payments surpluses and deficits was skewed in relation to the distribution of quotas: very large payments surpluses were concentrated in a comparatively small number of countries with relatively small quotas, while payments deficits were far more widely distributed and were large relative to most members' quotas. Under these circumstances, the Fund's liquidity was not sufficient to sustain a large demand for its resources without resort to borrowing, in the absence of a relatively large and early increase in quotas. The large-scale resort to borrowing between 1974 and 1984 reflected both the heavy demand for use of the Fund's resources and the need to bridge to the increases in quotas in 1980 and 1983.

2. Each instance of borrowing by the Fund has, however, had its own specific circumstances which have influenced the amounts sought, the potential sources of credit, and the particular terms of individual borrowing agreements. Nevertheless, a number of features have been common to most, if not all, borrowing agreements entered into by the Fund. In particular, thus far all Fund borrowing has been from official sources. The preference for borrowing from official sources reflects in large part the nature of the Fund as a cooperative, intergovernmental institution. However, recourse to the private capital markets is legally feasible and has been considered by the Fund on several occasions. Borrowing from the private capital markets has been opposed by a number of Executive Directors because of concerns that market borrowing could undermine the cooperative

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1/ The GAB, which had their own review provisions, would, of course, continue to be available.

2/ Decision No. 9862 (91/156), adopted November 15, 1991.

character of the Fund, lead to long-term permanent borrowing which would not be advisable and would undermine the Fund's quota-based structure, and would be costly which would have negative consequences for the concessionality of Fund credit that might lead to a reluctance on the part of member countries to make use of Fund resources at existing levels of conditionality.

3. The Fund also considered in 1980-81 short-term placements with members' central banks, which could broaden the participation of the Fund's membership in providing financial support to the Fund and also provide participating central banks with an avenue for reserve diversification. Specifically, it was envisaged that, in addition to bilateral borrowing agreements, the Fund could obtain additional resources from the monetary institutions of member countries, including those indebted to the Fund, with reserves positions such that there was a likelihood that the claims on the Fund so established would be held reasonably firmly. In the event, such placements were not made by the Fund and the Fund's borrowing continued to concentrate on traditional bilateral borrowing arrangements, although the World Bank subsequently established an IBRD Central Bank Facility under which it has borrowed relatively large amounts of funds on a short-term, revolving basis. The importance of an approach along these lines was that financial support to the Fund would be provided by a wide range of members.

4. Throughout its experience of borrowing, the Fund has maintained the principle that it does not accept an exchange risk, and therefore Fund borrowing has consistently been denominated in its own unit of account, first gold and since 1974, SDRs. The Fund may not borrow SDRs. Borrowing by the Fund replenishes its holdings of members' currencies. Most borrowing agreements have provided that the lender make available either U.S. dollars or its own currency, with, at times, provision for conversion of the latter into U.S. dollars or another freely usable currency. The possibility of change in the method of valuing the SDR has raised issues in this regard.

5. In undertaking borrowing, the Fund has generally sought to match the maturities of its liabilities with the purchase and repurchase schedules related to the extension of Fund credit. This "pass-through" technique has avoided difficulties with respect to the Fund's holdings of creditor members' currencies. At the time of borrowing for enlarged access, when it was not possible to match maturities so closely, the Fund developed a means of managing the borrowed funds through the establishment of the Borrowed Resources Suspense Accounts.

6. The liquidity and marketability of claims on the Fund have reflected the character of the Fund as a source of balance of payments financing and the particular needs of the Fund's creditors. Fund borrowing agreements with countries or their monetary institutions have provided for encashment upon representation of a balance of payments need and, further, that the Fund would give such representation the benefit of any doubt. Notwithstanding this special attribute of claims on the Fund, liquidity and marketability have been enhanced as needed in the light of creditors' circumstances, for example, through the transferability provisions of the

SFF loan agreements or by the provision of bearer notes in the case of the 1981 loan agreement with SAMA. The liquidity attributes of Fund borrowing have meant that monetary institutions have been able to include their loan claims on the Fund as part of their holdings of foreign exchange reserves.

7. Over time, the interest paid by the Fund to creditors has evolved considerably, rising from the relatively low, fixed rates of the early borrowing agreements (which reflected, inter alia, the experience of the first stage of the GAB), through rates still fixed but closer to market rates under the Oil Facilities, and to floating, market-related rates from the time of borrowing for the SFF onward. This evolution has paralleled the rising concern of member country monetary institutions to earn a competitive rate of return on their assets. The cost of borrowing by the Fund, plus a small margin, has been passed directly on to users of Fund credit financed by borrowed resources through the rate of charge. In some cases, separate arrangements (e.g., with respect to the 1975 Oil Facility and the SFF) have been made to subsidize this cost for eligible low-income countries.

8. While the Fund has generally borrowed to finance special facilities in the Fund, with particular repurchase terms and a particular schedule of charges to reflect the maturity and cost of the related borrowing, the Fund can more flexibly borrow to augment its ordinary resources. In this event, the proceeds of borrowing could be comingled with the Fund's ordinary resources and the maturities of borrowing could be fixed independently of the repurchase terms normally associated with the use of Fund credit.

9. The Guidelines adopted by the Fund with respect to borrowing emphasize its temporary, supplemental nature, and that the confidence of creditors will depend not only on the prudence and soundness of the Fund's financial policies, but also, in particular, on its role in promoting adjustment. As currently in force, these Guidelines prescribe that, in advance of any further borrowing that might be undertaken by the Fund outside of the GAB, the Executive Board shall establish in the context of the circumstances prevailing at the time limits expressed in terms of the total of Fund quotas, above which the total of outstanding borrowing plus unused credit lines would not be permitted to rise.

10. The occasions on which borrowing has been undertaken by the Fund have been when the Fund's liquidity position has been or appeared prospectively low or, which is the other side of the coin, when potential demands for the use of Fund resources have been high in relation to members' quotas. The amount of borrowing has been determined in part by the distribution of payments surpluses and deficits in the world economy, especially in relation to the distribution of quotas, and also relative to the timing and prospective size of quota increases under general reviews. Borrowing has usefully supplemented the Fund's resources in particular circumstances and has thus helped the Fund to respond promptly to the balance of payments financing needs of members with appropriate flexibility and timeliness.

Guidelines for Borrowing by the Fund (1991)
Decision No. 9862-(91/156), adopted November 15, 1991

Quotas subscriptions are and should remain the basic source of the Fund's financing. However, on a temporary basis, borrowing by the Fund can provide an important supplement to its resources.

The confidence of present and potential creditors in the Fund will depend not only on the prudence and soundness of its financial policies but also on the effective performance of its various responsibilities, including, in particular, its success in promoting adjustment.

Against this background the Executive Board approves the following guidelines on borrowing by the Fund.

1. Fund borrowing shall remain subject to a process of continuous monitoring by the Executive Board in the light of the above considerations. For this purpose, the Executive Board will regularly review the Fund's liquidity and financial position, taking into account all relevant factors of a quantitative and qualitative nature.

2. In advance of any further borrowing undertaken by the Fund, except in the case of borrowing under the General Arrangements to Borrow, the Executive Board shall establish in the context of circumstances prevailing at that time, limits expressed in terms of the total of Fund quotas above which the total of outstanding borrowing plus unused credit lines would not be permitted to rise.

3. Any limits that may be adopted as a result of a review pursuant to paragraph 2 above are not to be understood, at any time, as targets for borrowing by the Fund.