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Summing Up by the Chairman
Emergency Financing Mechanism
Executive Board Meeting 95/85 - September 12, 1995

Directors welcomed the opportunity to consider the elements of a proposed "emergency financing mechanism" (EFM) which would strengthen the ability of the Fund to respond rapidly in support of members facing a crisis in their external accounts and seeking Fund assistance. Although the wording "emergency financing mechanism" suggests a more ambitious purpose, Directors in fact considered that the topic under discussion was an emergency procedure rather than a new financing mechanism.

Directors agreed that the essence of an emergency financing mechanism was to provide for exceptional procedures that, in the event a member faced a crisis, would facilitate rapid approval of Fund support while assuring the conditionality necessary to warrant such support. In this connection, Directors generally agreed that there was not necessarily a link between exceptional procedures to facilitate a rapid response on the part of the Fund, on the one hand, and exceptional access, or the need for supplementary financing, on the other. However, Directors noted that, in addition to a rapid response to an emergency, the Fund may need to provide potentially large and front-loaded access, which possibly would imply the need to call upon supplementary resources. Issues related to possible expansion of the GAB and/or the supplementary borrowing arrangements, and their modalities and criteria for activation, remain open for further consideration, and we may need to return to the question of linkages to the EFM as those discussions evolve. For the moment, however, I believe there is broad agreement among Directors on the main aspects of what would constitute emergency procedures.

While noting the staff's assurances regarding "moral hazard" and other issues raised during the Board discussion of the role of the Fund in August, most Directors stressed the importance of ensuring that the use of the emergency procedures would be limited to truly exceptional circumstances and that the Fund's role, in the context of such use, would remain catalytic. Further, use of emergency procedures would not be a guarantee against sovereign default. With regard to the key features of these emergency procedures, many Directors underscored the critical importance of strengthened Fund surveillance, and close cooperation between the Fund and the members, in order to help avoid a financial crisis and to facilitate a rapid response should a crisis occur. In that context, it was stressed by several Directors that it was a member's responsibility to come to the Fund early with a strong and comprehensive economic program in order to prevent a potential crisis from emerging and to limit the cost of repair.

There was very broad support for the circumstances and conditions under which emergency financing procedures could be initiated, and for the

procedures themselves, as suggested and clarified by the staff. Some Directors expressed concern about the lack of objective criteria to identify in advance what kind of financial crisis would require and warrant a rapid Fund response, but others noted that it would be difficult to define beforehand the characteristics that would constitute such a crisis. A number of Directors would prefer to limit the use of emergency procedures to situations involving significant spillover or contagion effects, but most noted that such an approach would unduly restrict the availability of emergency procedures. Some Directors pointed to the lack of consensus on the meaning, in particular, of the concept of systemic effects.

In their comments, a number of Directors have emphasized the importance of continuous and substantive involvement of the Executive Board in the utilization of emergency procedures. I fully agree and have assured you that management would inform the Board immediately of its intention to activate the emergency procedures. Close communication and consultation would be maintained throughout the process, about which I will have more to say later in this summing up, and I agree on the importance of ensuring early and broad-based support in any activation of emergency procedures.

With reference to the specific elements of emergency procedures, I would list them as follows so that there is clarity for members, the staff, management, and the Board.

- o The emergency procedures would be expected to be used only in rare circumstances that represented or threatened to give rise to a crisis in a member's external accounts requiring immediate response from the Fund. Identification of such an emergency would be based on an initial judgment by management, in consultation with the Executive Board, that the member was faced with a truly exceptional situation threatening its financial stability, and that a rapid Fund response in support of strong policies was needed to forestall or to contain significant damage to the country itself or to the international monetary system, it being understood that the potential for spillover effects would be an important element of the Board's final judgment.
- o The conditions for activation of emergency procedures would include the readiness of the member to engage immediately in accelerated negotiations with the Fund, with the prospect of early agreement on--and implementation of--measures sufficiently strong to address the problem. Prior actions normally would be expected. The member's past cooperation with the Fund, in particular its record of reporting and responding to the Fund's policy advice in the context of regular consultations and continuing surveillance, would have a strong bearing on the speed with which the Fund itself could assess the situation and agree on necessary corrective measures. Our important operating principle--the stronger the program, the stronger the Fund's support--would also apply here.

- o The Executive Board would be informed immediately by management of the intention to activate emergency procedures, the nature of the emergency and the initial outlines of the planned responses by the member and the Fund, and the likely timetable for Executive Board discussion of a proposed arrangement. Strict confidentiality would need to be maintained, and public statements should be careful not to prejudge the Board's exercise of its responsibility to take the final decision.
- o A short written report would be circulated to the Executive Board as soon as feasible, describing the member's current economic situation.
- o During the negotiations with the member, the Executive Board would be briefed regularly on economic and financial developments, the progress of negotiations, the likely key parameters of the program (including the level and phasing of access), the likely impact on the Fund's liquidity and the possible need to activate borrowing arrangements, and any changes in the initially envisaged timetable for Executive Board discussion of the arrangement. These briefings would provide the Board with opportunity to give guidance to management and the staff on the country's policies and the contemplated Fund assistance.
- o In instances where support from other creditors is likely to be important, consultations with key creditors would be initiated at the outset of the emergency. The Executive Board would be informed of relevant developments in this area, in the context of the regular informal briefings.
- o Once agreement had been reached on a program, documents would be circulated as soon as possible. The staff would aim to do this within, say, five days. The Executive Board would be prepared to consider the request for an arrangement as early as 48 to 72 hours after circulation of the documentation. Decisions regarding key parameters, including access and phasing, would be taken in the context of the Executive Board's consideration of the arrangement, in accordance with the existing rules and practices of the Fund.
- o The early involvement and high frequency briefing of the Executive Board would be a centerpiece of the procedures facilitating a rapid Fund response. Similarly, after approval of the arrangement, and during a period of very close monitoring by the staff to allow early and continuing assessment of the effectiveness of the member's policy response, the Executive Board would continue to be involved closely in monitoring progress until the emergency was definitively resolved. In most cases, it could be expected that the full review of the initial policy response and the reaction of markets to these policies would be conducted within one to two months of the approval of the arrangement,

with the aim of allowing modifications to policies as necessary in light of the evolving situation.

- o Directors agreed that there would be an understanding, rather than a legal obligation, that the member would make early repurchase of the resources made available under emergency procedures, provided the member overcame its crisis quickly.

I conclude from today's meeting that Directors agree that we should strengthen the Fund's ability to act quickly in crisis situations. Directors have endorsed the broad outlines of the proposed features of what could constitute emergency procedures. I will plan to report to the Interim Committee on this basis. Of course, there are issues related to supplementary financing arrangements still under discussion, and we will consider any implications of such arrangements for the emergency financing mechanism in due course.