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EBD/99/107

September 13, 1999

To: Members of the Executive Board

From: The Secretary

Subject: **Statement by the Managing Director on a New IMF Facility for
Y2K-Related Balance of Payments Difficulties**

The attached statement by the Managing Director on a possible new IMF facility for Y2K-related balance of payments difficulties is being circulated in connection with the item on this subject on the agenda of the meeting of the Interim Committee Deputies on Friday, September 17, 1999.

Att: (1)

Other Distribution:
Department Heads

**Statement by the Managing Director on A New IMF Facility
for Y2K-Related Balance of Payments Difficulties**

1. The Y2K computer bug is the legacy of a computer programming shortcut which, as 1999 draws to a close, may cause computers and some other systems to malfunction. Although businesses, financial institutions, and government agencies around the world have made considerable progress in repairing computer systems, the risk that Y2K problems will arise remains real. As discussed in the staff statement on Y2K contingency planning scenarios, circulated to the Executive Board on September 9¹, the potential consequences for international trade and growth of interruptions to production and shipments are significant. Equally important, if not more so, is the potential for temporary interruptions to international capital flows. In these circumstances, it is important that the Fund—for individual members, and for the system as a whole—be in a position to be able to provide financial assistance on appropriate terms to members experiencing Y2K-related balance of payments problems. While we have various vehicles that could be of help, I believe that we should give consideration to the establishment of a special temporary facility in the Fund, dedicated specifically to such problems.

2. The purpose of such a facility would be to provide members facing potential Y2K-related balance of payments needs with potentially large scale, front loaded, short term access to Fund resources on appropriate terms and subject to adequate safeguards. The principal features of this facility would relate to the defining circumstances of its use, the qualification of members using it, access, repurchase periods, charges, and the duration of its existence. These are discussed briefly below.

3. **Defining circumstances.** It would be necessary to define Y2K-related balance of payments problems in such a way that they could be reasonably distinguished from other types of balance of payments problems. Balance of payments needs deriving from real sector problems (such as oil pipeline shutdowns or other supply problems directly resulting from Y2K) would presumably be easier to distinguish from non-Y2K problems than would balance of payments needs deriving from actual or anticipated Y2K problems in the financial sector/capital account. The balance of payments consequences of the latter will depend importantly on expectations and confidence factors which could also reflect other considerations. This would particularly be the case for countries undergoing, or needing to undergo, underlying adjustment programs under which progress (or the lack thereof) could cause swings in market confidence and movements in the capital account over and above those that might be related to Y2K. However a definition of Y2K balance of payments problems were crafted, a substantial element of judgement would likely be required in determining whether a particular situation would qualify. This judgment would be informed

¹ World Economic Outlook—Year 2000 Contingency Planning Scenarios: Statement by the Staff Representative at EBM/99/96, BUFF 99/110.

by developments in financial markets generally and the member's particular circumstances would be assessed in this context.

4. **Qualification.** A facility providing members with relatively high front-loaded access, under which it would be difficult to apply much conditionality beyond prior actions, would raise difficult questions about the Fund's ability to safeguard its resources.² With a facility of this type, the need to safeguard Fund resources would make it especially important that the member had established a good record of cooperation with the Fund; that use of Fund resources from the facility was related confidently to Y2K financing needs; that the member was moving vigorously to deal with those elements of its Y2K problems that were amenable to its control; that the Fund be reasonably assured that the broader policy responses during the period of their resolution would be appropriate; and that the Fund be able to assess the member's capacity to repay positively and confidently. It would also be important that the member be making appropriate use of its reserves and other available sources of financing (i.e., the Fund should not be the only recourse) and that it either have no other significant balance of payments problems, or if it does, is addressing them in the context of an underlying program and associated arrangement under which conditionality is being applied in the usual way.

5. **Access.** The possibly large balance of payments needs that could arise, particularly from temporary capital account disturbances, would suggest that such a facility should have a fairly high access limit, perhaps up to 100 percent of quota, and, possibly, provisions for exceptional access, given the uncertainties and potential size of capital flows in relation to quotas. This would be apart from the limits applying to other facilities and policies. Financing under the facility would be provided in the form of outright purchases.

6. **Repurchase periods.** Actual Y2K problems that are being satisfactorily addressed should be resolvable within a reasonably short time frame and those that derive from fear of Y2K problems that do not, in the event, materialize should be reversible especially quickly. In such circumstances, it would be reasonable for a Y2K facility to operate with very short repurchase obligations, shorter even than those that apply under the SRF (2 to 2½ years). Under the latter, the restoration of the loss of confidence in the member's capital account is

² The need to safeguard Fund resources might suggest that consideration could be given to the use of collateral. The use of collateral as a means of safeguarding the Fund's resources in cases of very high access was explored in *Safeguards for the Fund in Cases of Very High Access—Preliminary Considerations* (EBS/96/182, 11/27/96). That paper concluded that there were a number of drawbacks to the use of collateral. In particular, appropriate collateral may not exist, its use may send adverse signals to other creditors as to the Fund's confidence in the member's program and it might also conflict with negative pledge clauses. It should also be noted that, in the 1976 commentary on the proposed Second Amendment to the Articles of Agreement, it is stated that "the Fund's practice, however, has not been to require collateral. It is not expected that this practice will be changed."

presumed to depend, in part, on the resolution of (or credible commitment to resolve) underlying problems which are likely to be of a more protracted nature than Y2K. At the same time, as with the SRF, it would be helpful to retain some flexibility in repurchase policy under the facility, to take account of the uncertainty surrounding the precise timetable of the resolution of Y2K problems. These considerations might suggest repurchase obligations of, say, one year, with repurchase expectations at, say, six months. The latter could be extended by the Board on request of the member, up to the point at which repurchases became obligatory.

7. **Charges.** Incentive for members using such a facility to repurchase early (earlier still than the expectations) should circumstances improve more quickly than expected could be strengthened by the application of a surcharge in addition to the basic rate charge. If a Y2K facility were to operate with repurchase obligations as short as suggested, a flat surcharge of, say, 100 basis points might be appropriate. Perhaps the surcharge could be increased to 200 basis points if an extension of the repurchase expectation were agreed.

8. **Duration.** Possible Y2K-derived balance of payments needs are generally considered likely to be concentrated in the quarters on either side of the New Year, especially those in the capital account that derive from anticipation of Y2K problems. It would therefore be reasonable that a Y2K facility have a life extending to around end-March or end-June 2000.

9. Since a member has the right to use resources from the credit tranches for any balance of payments need, including Y2K-related balance of payments needs, a member facing such a need could not be required to use a Y2K-dedicated facility in lieu of access to the credit tranches. It could, however, be asked to make a mutually exclusive choice between them. Since resources under a Y2K facility would be available on a more frontloaded basis (i.e, up to 100 percent of quota as an outright purchase) than those from the credit tranches under arrangements, a member would likely elect to use the facility in the circumstances of relatively large and sudden Y2K-related balance of payments needs, notwithstanding that these resources would be more expensive and shorter term than those generally available from the credit tranches. A member facing relatively small balance of payments pressures from Y2K problems might, however, elect to use resources from the credit tranches.

10. As indicated in the latest review, the Fund's liquidity position is strong, and the baseline projection is for a substantial further strengthening over the next two-years. We have no basis for confidently predicting the scale of any Y2K-related balance of payments problems or how they might materialize in requests for use of Fund resources. Hopefully, any problems will be modest, and the existence of a Y2K facility in the Fund could itself be a reassuring factor, helping to forestall them. If larger problems do arise, the impact on the Fund's liquidity could be significant but, under the terms suggested for a Y2K facility, of short duration and from a strong base.

