BUFF 94/66

Office Memorandum

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July 1, 1994

To: Members of the Executive Board

From: The Acting Secretary

Subject: Managing Director's BUFF on SDRs, Access, and CTAs

The Managing Director considers it important that the Board have an early opportunity to express its views on the elements of the package described in his attached Buff statement. For this reason, he intends to convene an informal session of Directors on Wednesday, July 6, 1994.

Attachment

BUFF/94/66

July 1, 1994

Statement by the Managing Director on
Access Limits, SDRs, and Cofinancing Trust Accounts
Informal Session 94/5
July 6, 1994

In light of our recent discussions on the SDR and on the role of the Fund in financing the economies in transition and the broader issues that have been raised regarding access by all members to the Fund's resources, I would like to outline the elements of a comprehensive package to help provide a basis for agreement among Directors on these important issues.

1. Access Policy Under Fund Arrangements and the STF

a. Access under stand-by and extended arrangements

On access policy, I would suggest that we proceed with a temporary increase in the annual access limit applying to stand-by and extended arrangements. The staff had proposed an increase in the limit to 85 percent of quota. While most Directors could support this proposal, particularly as part of a package, some Directors would prefer a higher limit. I know some of you have strong reservations about increasing access limits much beyond the staff's earlier proposal and I appreciate the reasons for your caution on this matter. Nevertheless, to balance the various views and issues, I believe an increase to 90 percent of quota--together with a reminder that the exceptional circumstances clause remains available if the need arises--would provide a solid contribution toward a broader package. The proposed increase is intended to provide confidence to members with potentially large financing needs--including, importantly, the need to accumulate more quickly appropriate levels of reserves--that the Fund will be in a position to respond in a timely manner and on an appropriate scale in support of strong policies. Since the potentially large needs of some of the countries concerned could persist for a number of years, I would suggest that the increase in the access limit be effective for a period of three years after which the limit would revert to its current level. Of course, the situation will be reviewed annually.

Among those members facing large balance of payments needs are a number of the transition economies, but also other members adopting particularly bold stabilization and reform programs. As the needs of these members are met, we can expect to see an increase in the average level of access (as a percent of quota) provided under Fund arrangements. However, there is also a broader question as to whether, for the membership more generally, average access should increase beyond what it has been since the current limits were set at the time of the last quota increase. The views of Directors on this issue at our meeting on June 17 were mixed, with some Directors emphasizing the need for the Fund to play a larger--while still catalytic--role in financing members' adjustment programs. I take it to be the sense of the

Board that, to the extent it is justified in terms of the strength of the programs adopted and the needs for balance of payments financing under those programs, recommendations to provide access above the levels prevailing over the past few years would be seen as appropriate. This could be expected to raise further the average level of access provided under stand-by and extended arrangements.

b. Modifications to the Systemic Transformation Facility

Regarding the Systemic Transformation Facility (STF), Directors generally favored an extension of its availability for another year, permitting a first purchase under the facility to be made until end 1995. Many Directors also supported an increase in the access limit, although a number believed that such a move would not be appropriate. Directors generally expressed concern that the staff's proposal as it was formulated for our June 17 discussion could weaken the incentive for members to move to an upper credit tranche arrangement and that potentially larger resources for stand-alone STF purchases could increase the risks to the Fund. Directors also thought that the proposed five tranches would be too complex. Among those Directors favoring an increase in STF access, there was considerable support for simplifying the staff proposal by keeping the first two purchases at 25 percent of quota and adding a third purchase, of perhaps 35 percent of quota, that would be made available only in the context of an upper credit tranche arrangement.

The staff elaborated on the motivation underlying its proposals at the June 17 meeting. The point was stressed that there was no intention to weaken conditionality or to reduce the incentives under the STF to move expeditiously to an upper credit tranche arrangement. At the same time, the staff saw a role, in what they considered would be a very few cases, for maintaining the possibility of additional stand-alone purchases, admittedly as a fallback position, when the hoped for progress toward an upper credit tranche arrangement took more time than initially anticipated. We agreed to reflect on these issues in light of Directors' views and to seek to reconcile the various considerations, including the desire of many for simplicity. After further reflection, and considering the proposed increase in access under stand-by and extended arrangements, I would put forward for your consideration the following proposals for modifying the STF.

-- The first two STF purchases of up to 25 percent of quota each would continue to be available on the same basis as under the current decision.

-- Additional STF resources of up to 30 percent of quota would be made available in two purchases of up to 15 percent of quota each.

-- There would be a strong presumption that the third and fourth STF purchases would be made available only in the context of a Fund arrangement. A third or fourth purchase could be made on approval of an arrangement or on completion of a review under an arrangement. This would maintain the strong incentive for members to move to upper credit tranche arrangements as soon as possible. Two purchases rather than one would provide greater flexibility in the phasing of overall resources made available to the member. For example, while it would be possible to front-load the total resources provided in the context of an arrangement, this could be avoided, in appropriate cases, where disbursements needed to be phased in line with future policy steps.

-- I think it would also be desirable to provide some flexibility to permit third and fourth stand-alone purchases in the exceptional circumstances that a small number of late starters may face. A possible example would be a member that is making serious reform efforts resulting in significant progress, but where there are doubts about whether sufficient institutional capacity and policy instruments yet exist to implement an upper credit tranche arrangement. In order to maintain Fund financial involvement in these circumstances, we might leave open the possibility of additional stand-alone purchases to help sustain the member's reform efforts. Of course great care would have to be exercised in allowing stand-alone purchases, and the Board would decide how to proceed with these situations on a case-by-case basis.

-- The availability of the first STF purchase would be extended to end-1995 and the last date for all other purchases would be mid-1997. There would normally be a six-month interval between STF purchases, but the requirement that the second purchase be made no later than 12 months after the first purchase would be eliminated.

c. Access under ESAF arrangements

A question has been raised regarding the implications of an increase in the access limit under stand-by and extended arrangements for access policy under the ESAF. It is the view of a few Directors that the provision of resources under ESAF arrangements has been highly constrained, resulting in either an undue compression of imports, unduly slow accumulation of reserves, or requests for bilateral funding that have severely strained resources available from those sources. The stock of resources committed to ESAF by contributors is limited, and it has always been the intent to try to assure the availability of those resources to as many eligible countries as possible. This is even more important now that the list of eligible members has been expanded to include a number of the transition economies that are expected to require relatively large resources under ESAF arrangements. As indicated in the paper discussed on June 17, it would be feasible to handle a few such cases within existing resources; however, a general increase in access for all ESAF-eligible countries would severely constrain the little margin that was available under the initial target for the expanded ESAF--and, of course, even that initial target has not yet been reached. It could be appropriate in some cases to blend ESAF resources with GRA resources, but the scope for this will be limited if the Fund is to continue--as it should--to provide support to the poorer countries still confronting severe external difficulties on terms that will help assure resolution of their problems rather than compounding them later on.

In deciding access to ESAF resources in individual cases, a number of factors are taken into account, including the need to husband these resources as described above. Staff could weight this factor less heavily than it has in the past, but I would recommend that course of action only on the clear understanding of its implications: most importantly, that it may advance the date when ESAF resources have been fully committed and under circumstances in which some eligible member countries may not have been provided the support their adjustment efforts warrant. Thus, to proceed in this direction--which is indeed a direction that will help to ensure an evenhanded approach--there must be a clear sense from the Board of these implications of higher access to ESAF resources. In order to permit the Fund to remain in a position to have the concessional resources it needs to support the reform efforts of its poorest members, we will need to consider whether and how to further enlarge and extend the ESAF including, if necessary, using a limited amount of the Fund's gold.

2. SDR Allocation

Turning to the subject of the SDR, I believe the time has come to move forward toward a recommendation that can be presented to the Interim Committee at the Madrid meetings. Personally, for reasons I have previously stated, I still favor a straightforward general allocation of SDR 36 billion as the most expeditious method both to provide a needed supplement to other sources of growth in the world supply of reserves and to provide new members of the Fund with a significant stake in the SDR system. However, while most Directors continue to support this approach, it appears that there is not yet the requisite voting majority to proceed with a general allocation alone. Moreover, as many Directors recognize, there are sound reasons for considering a possible amendment of the Articles in order to address the issue of "equity." A compromise that will secure the requisite voting majority could need to combine the features of such an amendment with those of a general allocation.

Concerning the possible amendment, I would hope that the Board could now reach a consensus concerning its main features so that the staff may proceed to prepare the relevant draft documentation; SDR allocations pursuant to such an amendment would not be based on a long-term global need for reserves and would stand separately on their own merits. I would encourage Directors who have not previously expressed their views on these issues to do so at the meeting on July 6, under the working assumption that there will be some form of amendment. Symmetrically, I would encourage Directors to state clear positions on the size and phasing of a general allocation of SDRs that they would be prepared to support. At the Board meeting on June 23, most Directors who spoke on the issue favored an amendment based on "Method III" as described in SM/94/152, "SDR Allocation--Illustrative Calculations." Such an amendment would allow all members of the Fund with ratios of net cumulative SDR allocations to current quotas below a critical benchmark the one-time opportunity to raise their SDR allocations to correspond to this benchmark ratio. Directors supporting this approach generally suggested benchmark ratios in the range between 17.42 percent (equal to the ratio of total SDR allocations to total quotas for members that have participated in all previous allocations) and 25.8 percent (equal to the highest ratio of SDR allocations to quota for countries that have consented to increases in quotas under the Ninth General Review).

For a number of reasons, I would now urge that the Board find consensus on an amendment in the form of Method III, with the benchmark ratio set at a relatively high level. First, with Method III we would avoid thorny issues of eligibility and of "reverse inequity." Specifically, under this form of amendment no newer member of the Fund would have the opportunity to acquire a higher ratio of SDR allocation to quota than the ratio for any older member of the Fund. Second, for those who believe, as I do, that there is a significant global need to supplement existing reserve assets through a new allocation of SDRs, there should be no objection (other than possible delay in ratification) to meeting part of this long-term global need as a consequence of an amendment of the Articles that addresses the issue of equity. Third, as a practical matter, it may be easier politically to secure ratification of an amendment, and to secure ratification more quickly, if a greater number of members would find their individual SDR allocations directly and significantly affected by the amendment.

We could consider alternative approaches to establishing a benchmark ratio. We have discussed the ratio of 25.8 percent. Another approach would be to reestablish the effective ratio that prevailed before the large expansion of the membership. For example, the average ratio of net cumulative allocations to quotas at end-1989 stood at 23.7 percent. Or we could select a somewhat higher ratio, say, 30 percent, which would mean that part of the selective allocation would be distributed across the membership in proportion to current quota like a general allocation. The selective allocations under these alternative benchmark ratios would amount to SDR 16.0 billion under the first alternative, SDR 13.2 billion under the second alternative and SDR 22.0 billion under the third. Such allocations would range from 37 percent to 60 percent of the allocation that I have recommended on the basis of long-term global need.

As many Directors have suggested, a general allocation of SDRs should be considered in conjunction with the SDRs that would be provided through an amendment, perhaps based on Method III with a high benchmark ratio. I would suggest that most or all of such a general allocation should come promptly, while we await ratification of the amendment providing for the special allocation. The size of the general allocation should, in my view, fill in the difference between the SDR 36 billion that I have proposed and the total SDR allocation that would be made available under the amendment.

To move forward toward a consensus on the question of SDR allocations, allowing adequate time for the preparation and discussion of the necessary details before the Madrid meeting, it would be useful if Directors could now address the following questions. First, assuming that there will be both a general allocation and an amendment to provide for special allocations to deal with the issue of "equity," would Directors favor, or be prepared to accept, Method III as described in SM/94/152? Second, under this form of amendment, what benchmark ratio for special allocations would Directors favor, and what ratios would they be prepared to accept? Third, would Directors want the amendment to allow future members of the Fund an appropriate opportunity to acquire special SDR allocations after joining the Fund? Fourth, under the assumption that there will be an amendment to provide for special allocations in accord with Method III with a relatively high benchmark ratio, what size and, if any, phasing of a general allocation of SDRs would Directors favor, taking account of the allocations made available under the amendment? Finally, would Directors recommend, as I would suggest, that we consider reinstituting a reconstitution requirement?

3. <u>Cofinancing Trust Accounts</u>

In our recent discussions, many of you responded positively to the concept of cofinancing trust accounts (CTAs) and the role they could play in providing additional resources--not only in the context of an allocation but also for the utilization of existing SDRs--to members undertaking adjustment programs; some of you even indicated an interest in providing financing through this mechanism. Your comments on the possible features of such accounts, including the important qualities of liquidity and security, have been helpful and we will come forward with a paper for further consideration.

4. <u>Related Issues</u>

Many Directors are rightly concerned about the potential impact over time of the proposed higher access limits on the liquidity position of the Fund; the staff will closely monitor developments, especially in relation to discussions concerning the Tenth and Eleventh Review of Quotas. On burdensharing, many of you have stressed the need to address the issues explicitly and comprehensively. Personally, I recommend that we aim for better balance in the distribution of the costs of operating the Fund. You will have a paper discussing alternative approaches to burdensharing shortly, for discussion on July 20.

5. <u>Concluding Remarks</u>

During our discussion on June 17, many of you mentioned the historic challenges of integrating the transition economies into the international monetary and trade system, the central role of the Fund in this process, and the need to preserve the monetary character and catalytic role of the institution through a concerted effort by the international community. As I indicated earlier, I am prepared to go forward with these proposals on the understandings that they command the broadest support among the membership; that the membership stands ready to increase Fund quotas should the Fund's liquidity position fall close to the traditional threshold for considering this; that although the average level of access provided under Fund arrangements could be expected to rise, there is to be no weakening of conditionality and the Fund's role is to remain essentially catalytic; and that the membership, through you, reaffirms the Fund's preferred creditor status and readiness to provide financing in the future, in the terms provided when the STF was established (see Buff 93/19, April 23, 1993).