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700 19th Street, NW
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IMF Reforms Exogenous Shocks Facility

On September 19, 2008, the Executive Board of the International Monetary Fund (IMF) approved modifications to its Exogenous Shocks Facility (ESF). The ESF was established in 2005, and became effective in 2006 following the consent of contributors to the Poverty Reduction and Growth Facility (PRGF)-ESF Trust. The decision adopted by the Executive Board to modify the ESF will take effect once all lenders to the Loan Account of the PRGF-ESF Trust, and all contributors to the Subsidy Accounts of the PRGF-ESF Trust, consent to the amendments.

Background

The IMF keeps its facilities under regular review to ensure that they meet the evolving needs of its members. The recent episode of rising food and fuel prices was one factor behind the acceleration of a review of the IMF's facility providing support for low-income members that are affected by exogenous shocks. This is especially important because such events can have significant negative economic impacts on low-income countries, especially those whose economies lack diversification and have limited capacity to build up reserves. In such cases, there is a clear role for the international community to supplement national efforts for reducing vulnerability to shocks. At its April 2008 meeting, the International and Monetary Financial Committee (IMFC) expressed support for work on the ESF to enable the Fund to respond more quickly and effectively to low-income members' needs.

These issues have been considered previously in discussions of the Fund's instruments and financing for low-income countries (PIN No. 04/40), the Fund's support of low-income member countries (PIN No. 04/110), and more, specifically, the establishment of the Exogenous Shocks Facility (PIN No. 05/163).

When establishing the ESF (see Establishment of an Exogenous Shocks Facility Under the Poverty Reduction and Growth Facility Trust and Supplement I) the Executive Board agreed that, for purposes of the ESF, an exogenous shock would be understood to be an event beyond the control of the authorities of the member, with a significant negative impact on the economy. In its discussions on Proposed Reforms to the Exogenous Shocks Facility and Supplements, the Executive Board reiterated that shocks arising from shortfalls in aid or domestic policy slippages would not be covered. The Executive Board also agreed on various operational modalities and financial structure for the ESF.

In concluding discussions on Proposed Reforms to the Exogenous Shocks Facility and Supplements the Executive Board agreed the following **key features for the modified ESF**:

• **Creation of a new rapid-access component** under which a country could access fairly quickly, up to 25 percent of its quota for each exogenous shock, with resources normally being provided in a single disbursement. This component could be used on a stand-alone basis or could be a first step towards higher access.

• **A high-access component, along the lines of the current ESF**, with access up to 75 percent of quota for each arrangement in normal circumstances. Resources would be provided in multiple disbursements based on reviews. Financial assistance under this component could be used following a drawing under the rapid-access component, or on a stand-alone basis.

• **Tailored conditionality and requirements for access to ESF financing**. Under the rapid access component the member would need only to commit to appropriate policies to address the shock, and in exceptional cases, to take targeted upfront measures. Under the high-access component an economic program of upper credit tranche quality would be needed.

• The **ability to be used more flexibly** in conjunction with other Fund facilities and instruments, for example, with a Policy Support Instrument (PSI).

• **Maintaining a focus on the impact of the shock and the related policies on the poor** in program design, while dropping the previous requirement for a Poverty Reduction Strategy.

Executive Board Assessment

Executive Directors welcomed the opportunity to reform the Exogenous Shocks Facility (ESF), as requested by the IMFC at its Spring 2008 meeting, to make it more useful to low-income members through increased and more rapid access and streamlined requirements. They acknowledged the importance of moving ahead with the ESF reforms in light of the worsening global economic conditions.

The Executive Board today approved the decision on the reform of the ESF and heard Directors' views on how several aspects of the reform should be framed. Views varied on a range of issues, including: the requirement that the shock be "sudden," the extent of policy conditionality and prior actions, the size and frequency of access, and the eligibility of countries with an off-track PRGF arrangement. However, the Board arrived at a mutually acceptable compromise that, although not meeting all Directors' preferences in all respects, represents a sufficiently strong middle ground for the Fund to move ahead to help countries deal with exogenous shocks. It was understood that aspects of the ESF reform would be revisited in the context of the forthcoming comprehensive review of the Fund's lending framework. A number of Directors noted, however, that it would have been preferable to have undertaken the ESF review in the context of the general review, in order to ensure consistency of Fund financing facilities and conformity with the Fund's mandate and strategic direction.

On eligibility and qualification, Directors agreed that the access criteria would remain unchanged, namely, an actual balance of payments need for which the primary source is a sudden and exogenous shock. However, a number of Directors emphasized that the requirement of "suddenness" should not be used to restrict access for countries hit by an unexpected shock, or one whose impact is somewhat protracted such as the fuel and food price shock. As recognized when the ESF was originally established, the determination of whether a shock is "sudden" will need to be assessed judgmentally taking into account all relevant factors. The overall balance of payments position would also need to be taken into account in considering the member's needs. Shocks arising from shortfalls in aid or domestic policy slippages would not be covered.

On policy commitments and approval standards under the rapid-access component, Directors supported the requirement that a member commit to appropriate policies to address the shock. In this regard, Directors noted that it would be important to distinguish between countries with fundamentally sound policies before the shock and countries with fundamental policy weaknesses. It was agreed that, in exceptional cases, upfront measures may need to be implemented to confirm that the approval criteria have been satisfied, although some Directors considered that this policy could conflict with rapid access, while a few felt that it should be more broadly applied. Policies meeting the standards of upper credit tranche conditionality would not necessarily be required. Approval would be granted where the Fund is satisfied that the member will implement an appropriate set of policies to address the shock, and that the member, more generally, will cooperate with the Fund in an effort to find, where appropriate, solutions for its balance of payments difficulties. Regarding the high-access component, a member will need to commit to a one-to-two year upper credit tranche-quality economic program, with conditionality focused on the macroeconomic and structural measures aimed at adjusting to the shock. A few Directors underscored that members needing deeper structural efforts to ensure external stability should benefit from support under a PRGF arrangement.

On access, most Directors supported an access limit of 25 percent of quota per shock under the rapid-access component, and a normal access limit of 75 percent of quota per arrangement under the high-access component, less any outstanding disbursements for the same shock under the rapid access component. Some Directors would have preferred somewhat lower access limits given debt sustainability concerns, while a few others believed that the small size of many countries' quotas warrants higher access levels. Some Directors stressed that, in considering the level of access for individual countries, the Fund should give due regard to the need to preserve debt sustainability.

Directors agreed that the impact of the shock and the related policies on the poor should be important considerations in the design of policies, but that members will no longer need to have in place, or develop, a poverty reduction strategy in order to qualify for assistance under the ESF.

Directors agreed that a member's initial request for assistance under the rapid-access component would require a commitment to undergo a safeguards assessment, and that such an assessment would normally need to be completed before the member could obtain approval of any disbursement under the same component for a second shock within a five-year period. Under the high-access component, Directors agreed that a safeguards assessment would need to be completed at least by the time of the first program review. Consistent with the policy on safeguards assessment, the relevant assessment could be a new assessment or an update assessment, the latter in cases where the member has already been subject to a safeguards assessment.

Directors believed that the decision taken today will allow for better interaction of the ESF with other Fund facilities and instruments. So long as the approval requirements are met, support under the rapid-access component could be provided to members implementing Staff Monitored Programs (SMPs) or Policy Support Instrument (PSI)-supported programs, receiving support under Emergency Post-Conflict Assistance (EPCA), or in some circumstances, with off-track PRGF arrangements. In the case of off-track PRGF arrangements, this would be most likely to apply where the arrangement is off-track entirely or mainly due to slippage in the area of structural reforms. In cases where a PSI runs concurrently with an ESF arrangement, Directors supported the alignment of PSI and ESF program targets, review schedules, and program documentation.

On repeated use of the ESF, most Directors agreed that support under the rapid-access component, when not followed by a Fund-supported program related to the same shock, would normally be available for no more than two shocks within a five-year period. They noted that a member experiencing more than two such shocks during a five-year period could receive assistance in the context of a program supported under the high-access component or the PRGF. A number of Directors, however, felt that this policy could impede support for countries that are subject to frequent exogenous shocks.

Directors concurred that the resources available under the PRGF-ESF Trust would likely be adequate to meet short-term needs. If demand turned out to be very strong, consideration could be given to completing the original fund-raising exercise for the ESF, and/or advancing the date for the initiation of self-sustained PRGF-ESF operations.

Directors noted that, in order to become effective, the decision adopted by the Board would require consent to the PRGF-ESF Trust Instrument amendments from all current lenders and bilateral subsidy contributors to the Trust. Directors looked forward to the early receipt of consents from all lenders and contributors.

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