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Aide-Mémoire by the Chairman
Currency Stabilization Funds - Fund Policies
Preliminary Consideration
Executive Board Meeting 94/109, December 14, 1994

I would like to thank all of you for your thoughtful gray statements and comments on the interesting issues raised in the staff paper and for the frank and lively exchange of views we had today on the pros and cons of possible involvement of the Fund in the area of currency stabilization funds (CSFs).

The preliminary nature of today's discussion reflects the fact that this was only the first reading of a still evolving concept. With this in mind, it might be useful, by way of an aide-mémoire, to record some of the main points, suggestions, and reservations raised by Directors as guidance to the staff in its further work. I would suggest that as the next step the staff would return with a more precise proposal for consideration, taking account of today's discussion.

Many Directors expressed general interest and support for Fund financing for CSFs, but others were skeptical of the need for special policies in this area. Those Directors who expressed interest in Fund financing for CSFs felt that such operations would be consistent with the purposes of the Fund and, in certain circumstances, could significantly help a member adopting a strong anti-inflationary program. These Directors stressed that a CSF should be an instrument of infrequent use. The Directors who questioned the need for CSFs thought that the Fund could adequately support members' exchange rate policies, including policies involving a nominal exchange rate anchor, under existing policies. Questions were also raised about whether policies supporting CSFs would be available to all members or tailor-made for a few cases. In this connection, several Directors felt that the conditions necessary for successful use of CSFs were not yet sufficiently elaborated in the staff paper to differentiate the type of situations in which Fund support for CSFs would be appropriate, and they requested further work in this area.

All Directors agreed that CSFs could be effective only in the context of a strong stabilization program supported by a Fund arrangement. On this condition, we--staff, management, and Executive Board--are unanimous. Currency stabilization funds could, in certain circumstances, be a powerful complement to appropriately tight fiscal and monetary policies and could provide an important element of additional confidence to a nominal exchange rate anchor. Resources under a CSF should never be used for general balance of payments financing; they should only be available, if needed as a confidence-building device, for very short-term intervention to counter short-term foreign exchange market pressures, accompanied as needed by supporting macroeconomic measures. Several Directors commented that the most successful CSF is one that does not need to be used, and that limited or no recourse to a CSF during the course of a stabilization program would be fully consistent with its objectives.

There was considerable discussion regarding the exchange rate regimes to be supported by access to CSFs. A number of Directors saw a CSF as potentially most effective in conjunction with a nominal exchange rate peg supported by a comprehensive stabilization program aimed at rapidly reducing inflation. However, other Directors considered that a CSF might also be used in support of a crawling peg or some other arrangement that was less fixed than a peg. We should return to this issue. Some Directors also thought that CSFs might be useful to a country that aimed to unify its exchange rate in the context of a Fund arrangement or that had already achieved a measure of stability in its exchange rate and wanted to move to a nominal anchor. A few Directors questioned whether providing Fund financing for CSFs would indicate a preference by the Fund for fixed exchange rate regimes. In response to this last point, let me say that it was not the intention of the staff to suggest such a preference but rather to ask the question whether an additional instrument would be useful in certain circumstances involving a nominal exchange rate anchor. I think this is now well understood.

Directors supported the general proposition that CSFs should be available only in connection with Fund arrangements of upper credit tranche conditionality, but views differed regarding how, in practice, CSFs would be linked to these arrangements. Some Directors advocated integrating CSFs directly within Fund arrangements through a "window," but others would prefer to see CSFs established as a separate facility under which members would make purchases in parallel with a stand-by or extended arrangement. Several Directors noted that, as the staff paper has pointed out, the substantive differences did not seem great. It was understood that under either approach it would be possible to use CSFs in parallel operations with ESAF arrangements. We will carefully review Directors' comments and the pros and cons of each approach.

On the access aspects, and particularly in view of the recent increase in the annual access limit under stand-by and extended arrangements, most Directors considered that a maximum access limit of 100 percent of quota for a CSF should provide sufficient scope for the Fund to effectively support such operations. It was understood that it should not be expected that this ceiling would be utilized in each case. This is an upper limit, not a target. In contrast, some other Directors were concerned that introducing special policies in support of CSFs could lead to undue risks and potentially channel additional resources to a narrow segment of the membership.

Many comments were made about the potentially high risks associated with CSFs and the need for adequate safeguards. In recognition of the potential risks, most Directors thought that a tranching mechanism along the lines illustrated in the staff paper would provide scope for flexibility while safeguarding the Fund's resources, including by requiring Board approval of purchases beyond a first tranche. However, several Directors expressed concern that tranching, as described in the staff paper, could be unnecessarily complex and inflexible in practice, which might discourage possible users, and that excessive tranching could diminish the signalling effect of a CSF. These Directors would prefer fewer--say, three or four--and larger tranches than suggested in the staff paper.

Directors generally considered that a relatively short reconstitution period for CSF purchases would help to ensure that CSF resources would be used as intended. Most thought that the combination of a repurchase expectation of 3 to 6 months and a 12-month repurchase obligation period would be appropriate.

There was clear support among Directors for strict adherence to additional reporting requirements that would be applicable under a CSF; these would need to be met on a continuing basis. Members requesting a purchase under a Fund-supported CSF would also need to be prepared to take quick additional policy actions rather than, or in addition to, exchange market intervention.

Directors agreed that effective operation of CSFs would require changes in standard Fund procedures, including accelerated Board procedures for both documentation and decision-making, and that the flow of CSF-related information would have to be treated with the utmost confidentiality. It goes without saying that before finalizing any proposals in this area, particularly on more expeditious procedures, we will consult further with the Board.

Directors raised questions concerning the transaction costs associated with CSFs and requested that the staff further examine possible means to offset or reduce these costs.

While recognizing that close review would need to be kept over the Fund's liquidity position, most Directors considered that Fund support for CSFs could be met from the Fund's ordinary resources in present circumstances. Some Directors noted that the General Arrangements to Borrow (GAB) would remain potentially available in case of need under certain conditions, and a few Directors expressed interest in exploring possible cofinancing arrangements for CSFs, a matter to which we will return when preparing our next paper.

Today's discussion has provided the staff with considerable guidance. As I have already noted, we will aim now to bring more specific proposals to the Board in the next few weeks. Indeed, any further thoughts by members of the Board during this time of further reflection would be particularly welcomed by the staff and management.