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IMF Executive Board's Initial Discussion on Review of Fund Facilities—Analytical Basis for Fund Lending and Reform Options

On March 5, 2009 the Executive Board of the International Monetary Fund (IMF) held an initial discussion on the analytical basis for Fund lending in emerging market countries and reviewed options for reforming the lending toolkit.

Background

One of the key purposes of the Fund is to provide financial assistance, under adequate safeguards, to members facing balance of payments problems. Fund lending has a unique role in crisis prevention and resolution, and contributes to global financial stability by mitigating the risk that members' problems erupt into full crisis and spill over into other countries. Thus, it is essential that the Fund's lending facilities are effective for the needs of today. The Executive Board had an initial discussion on a wide range of issues surrounding the coherence and completeness of the Fund's lending toolkit; the flexibility and focus of instruments, including for insurance; the scale of lending; and the purpose and modalities of conditionality. This initial discussion was followed by further proposals which were discussed and adopted on March 24 2009.

Executive Board Assessment

Executive Directors welcomed the timely discussion of proposals to modernize Fund facilities and conditionality to enhance the Fund's capacity as a crisis responder at this critical time, but also to enact durable reforms that are effective beyond the current crisis. They considered a number of proposals to revamp the Fund's lending toolkit in the General Resources Account (GRA). Directors expected to discuss in the near future proposals to reshape the Fund's lending facilities and policies for low-income countries. In particular, they emphasized that uniform treatment of Fund members means that changes to conditionality policies should also apply to lending to low-income countries, as appropriate.

Revamping the Fund's GRA Facilities

Directors agreed that the Fund has a unique role in assisting members to prevent and resolve financial crises, including through the provision of sufficiently large and upfront financing. While surveillance was generally seen as the Fund's major tool for crisis prevention, most Directors considered an explicit crisis prevention instrument with such financing as a vital addition to the Fund's lending toolkit. In addition, Directors observed that, as it is hard to predict ex-ante the nature, magnitude, or duration of a crisis, the Fund's financing instruments need to be designed flexibly. In this connection, they agreed that the criterion of balance of payments need for use of Fund resources is not overly constraining, even now. The staff was encouraged to help members design effective programs to address financing shortfalls that are emerging as the crisis deepens.

Against this background, Directors generally endorsed the proposal to eliminate the Supplemental Reserve Facility and the Compensatory Financing Facility, which have been used very infrequently. A few Directors also supported the elimination of the Extended Fund Facility. Most Directors, however, did not, noting the benefits for low-income countries transitioning from Poverty Reduction and Growth Facility (PRGF)-supported programs and for middle-income countries confronting medium-term balance of payments adjustment needs.

Flexible Credit Line (FCL). Most Directors supported the creation of a new Flexible Credit Line (FCL), to provide high and rapid access to Fund resources to members with very strong policies and underlying economic fundamentals, and a sustained very strong policy track record. The FCL, which would be established as a window in the credit tranches, would address all balance of payments problems, including on a precautionary basis. As the FCL would encompass the key features of the Short-Term Liquidity Facility (SLF), the SLF would be eliminated in the context of the establishment of the FCL. A number of Directors pointed to several FCL design features that need to be resolved, such as evenhanded qualification of members, signaling issues associated with entry and exit, and adequacy of safeguards for Fund resources.

As regards the duration of the FCL, most Directors generally supported allowing members to choose between a six-month arrangement and a one-year arrangement with a mid-term review, both of which could be renewed, although some Directors considered that this possibility of choices may be confusing. However, a renewal of an arrangement or completion of a mid-term review would require Board approval. Some Directors considered a maximum duration of six months as appropriate in light of the possible rapid changes in a member's economic circumstances.

Directors strongly emphasized the need to establish a rigorous, specific, and transparent qualification framework, further elaborating upon the SLF criteria, to ensure that the FCL is made available only to members with very strong macroeconomic fundamentals and policies, as well as a sustained track record of implementing such policies, including a record of taking timely appropriate corrective actions. Such a clear qualification framework would promote self-selection by members, facilitate evenhanded treatment, and underpin the application of ex ante conditionality. Directors generally were of the view that assessment of a member's qualification should be undertaken confidentially and only at the request of the member.

Most Directors agreed that, like the SLF, the FCL would not be subject to the exceptional access framework, given the FCL's rigorous qualification requirements, and its procedures that would be substantively similar to those under the exceptional access policy. In this regard, these Directors stressed the importance of close and early involvement of the Board in making decisions on qualifications, ex ante conditionality, and access under the FCL. Most Directors did not support establishing a fixed-access cap for the FCL, wanting to retain flexibility to determine access on country-specific actual and potential financing needs and capacity to repay. A number of Directors, however, saw merit in such a cap, because precautionary access would be difficult to establish ex ante and because Fund resources are finite.

High-Access Precautionary Arrangements (HAPAs). Directors supported the clarification of the policy on precautionary Stand-By-Arrangements so that all members—including those that do not qualify for an FCL—would have access to an effective precautionary instrument with adequate financing, including beyond the normal access limits, where appropriate. In this regard, many Directors considered that HAPAs should be characterized by large and frontloaded access. A few Directors felt that HAPAs would be sufficient for the entire membership, obviating the need for the FCL. Directors recognized that the choice between an FCL and a HAPA would require difficult judgments on the strength of underlying policies, economic fundamentals, and track record of the member. These difficult judgments would place an additional responsibility on staff and the Board to ensure evenhanded treatment.

Most Directors called for a review of the exceptional access policy to address asymmetries in its application to capital and non-capital account crises, and to clarify assessments of debt sustainability. In particular, the review and associated reforms would reduce the existing constraints on precautionary lending in the exceptional access context.

Other Issues. A number of Directors called for greater efforts to involve the private sector, including the possible use of market-based instruments, in crisis prevention and resolution. A few Directors also stressed that the Fund should coordinate closely with other institutions that have precautionary lending instruments, such as the World Bank. A number of Directors suggested that the FCL should contain a three-year sunset clause with a Board review to determine whether it should be retained, while a few others preferred a review clause. Many Directors, however, noting that the FCL addresses a gap in the Fund's crisis prevention and resolution toolkit, considered its introduction to be a lasting reform.

Fund Liquidity and Precautionary Balances.

Many Directors questioned the adequacy of Fund resources for large-scale precautionary lending under the FCL and HAPAs, and whether such lending could crowd out Fund resources available for members facing actual crises. While a number of Directors argued in favor of capping access under the FCL and HAPAs, most Directors supported an approach wherein access to FCLs would be reviewed within two years or earlier if warranted by the Fund's liquidity situation. Most Directors suggested revising commitment fees and surcharge structures to improve price incentives to limit excessively high commitments of resources on a precautionary basis, to encourage timely repayment if Fund resources were drawn, and to accumulate adequate precautionary balances. They argued that commitment fees along with surcharges should reflect the credit risk associated with precautionary arrangements. However, a significant minority of the Board cautioned against making Fund financing unattractive to borrowing members. A few Directors considered that the Fund's burden-sharing mechanism should also be modified.

Conditionality

Monitoring policy adjustments through conditionality is a long-standing and fundamental element of Fund-supported programs, helping members to resolve their balance of payments problems and providing a key safeguard to Fund resources. Directors agreed that conditionality should be focused on measures critical for achieving the objectives of Fund-supported programs and be parsimonious in number. However, reform of Fund lending facilities would not be complete without re-examining conditionality modalities, particularly in light of their perceived shortcomings.

Directors discussed the merits of ex ante conditionality and the circumstances under which it would be appropriate. Most Directors supported use of ex ante conditionality for the proposed FCL, and some Directors suggested that a hybrid approach, combining both elements of ex ante and ex post (review-based) conditionality, be applied to HAPAs, as well. Some Directors pointed out that ex ante conditionality simply constitutes an eligibility criterion rather than case-specific negotiated policy conditions. As already discussed, Directors recognized that a well-defined qualification framework is critical and the period between reassessments needs to be short.

Many Directors saw advantages to the proposal to move to review-based conditionality, in particular eliminating performance criteria, which would also obviate the need for waivers in cases of nonobservance. They noted the inherent difficulty, especially in rapidly changing economic situations, of establishing precise performance criteria. Moreover, the proposed review-based approach would be consistent with the increased frequency of program reviews. Many other Directors, however, were concerned that elimination of quantitative performance criteria could reduce predictability and assurances to members about conditions under which Fund resources would be made available. A number of Directors considered that eliminating performance criteria, particularly quantitative ones, would reduce safeguards to the Fund's resources, weaken the Fund's positive signaling role, and diminish its effectiveness as a domestic commitment tool. Directors, however, generally agreed that greater efforts should be made to further streamline and better tailor structural conditionality. From this perspective, a few Directors suggested eliminating structural performance criteria, but maintaining quantitative performance criteria and structural benchmarks.

Next Steps

Most Directors stressed the urgency of moving quickly to modernize the Fund's lending framework, so that the Fund's role in responding to the current global crisis is maximized. To build on the momentum for reform and institute a flexible GRA lending toolkit, staff will prepare a paper that would allow the Board to take decisions on a package of measures, in particular, to: i) raise access limits and reform the exceptional access framework; ii) establish the FCL, clarify the use of precautionary SBAs, and streamline facilities; iii) reform structures for fees, surcharges, and maturities; and iv) better tailor and focus conditionality.