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Statement by Mr. Goos
on the Review of the Compensatory Financing Facility
and the Proposed External Contingency Facility
Executive Board Meeting 87/156
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I approach today's preliminary discussion of the issues before us from the following general propositions: First, that the Fund should limit its financial assistance to cases where balance of payments viability is expected to be restored in the medium term as a result of either self-correcting forces or appropriate adjustment policies. This proposition flows from the overriding need to safeguard the temporary use of the Fund's general resources and, hence, to avoid the emergence of arrears. Second, that the Fund should use its resources in a manner that is supportive of the restoration of balance of payments viability. And third, that we should avoid a proliferation of special facilities as opposed to the traditional focus of the Fund on general balance of payments assistance.

A. Review of the CFF

Against the background of the above considerations I feel that the analysis and proposals presented in the staff paper could substantially alleviate our concerns about today's operation of the CFF--concerns which we have repeatedly stressed in the past and are adequately presented in the paper.

1. Conditionality and related issues

I could support the thrust of the proposed modifications to phasing and conditionality inasmuch as in cases of non-viable payments positions they would establish a closer link between CF disbursements and actual adjustment.

However, I am concerned about the lean conditionality proposed for the initial tranche of CFF access which--as the staff points out (p.13)--could give rise to even "greater risk of Fund exposure" than to date. Strict interpretation of the requirement to protect the Fund's resources would suggest that in "non-viable cases" there is little room for a less stringent cooperation requirement than the one proposed for the higher tranches. I, therefore, would have to insist, as a minimum, on clear indications--preferably underlined by concrete action, including approval in principle of Fund arrangements--that the members in question are willing to cooperate with the Fund in seeking appropriate solutions. In any case, high standards should be applied in assessing the credibility of the willingness to cooperate. Moreover, the size of the initial tranche should not exceed 25 percent of quota.

Regarding the cooperation requirement for the higher tranches it appears difficult to allow for CF disbursements on the basis of Fund arrangements that have been approved "in principle" only. However, if combined with the actual implementation of strong prior actions one could perhaps consider access on an exceptional basis.

Eligibility of SAF arrangements and lower tranche stand-by arrangements should be assessed on a case-by-case basis. To the extent that such arrangements could be expected to restore medium-term viability (such as in less severe cases of payments problems) access to the higher tranches should be granted. I see little justification for a presumption that such arrangements should be generally eligible or ineligible for access to the second tranche.

2. Issues of implementation

The basic features of the current procedures for calculating export shortfalls should be maintained including the practice of nominal calculation of the shortfall in total exports and the exclusion of their import content. However, I could support the proposed introduction to the existing formula of a ceiling on export projections in order to contain overcompensation. A ceiling of 20 percent would appear appropriate in present circumstances. Also the staff's recommendation in regard to overcompensation in successive purchases could help alleviate our concerns.

Regarding the criteria of "beyond the control" I would strongly endorse the views expressed by Mr. Dallara. And like him I also could not support any liberalization of the cereal facility, the establishment of which was acceptable to us only because of its integration with the CFF.

3. Concessional CF financing

We have serious reservations about the creation of additional Fund facilities aimed at specific problems in particular where such problems are not of a monetary character. While appreciating the objectives behind the proposal of concessional CF financing, I feel that those objectives could be met in a more appropriate manner through channels outside the Fund.

B. Establishment of an external contingency mechanism (ECF)

In view of the similarity of the fundamental issues that arise from the contingency proposals made by the staff and the U.S. authorities, I shall try to assess those issues on the basis of the proposed ECF.

Today's uncertain external environment undoubtedly puts a high premium on efforts aimed at protecting ongoing programs against unexpected developments and at promoting adjustment and reform. I therefore welcome the thrust of the contingency proposals.

Nevertheless, we continue to have substantial doubts about the usefulness and appropriateness of contingency mechanisms in the context of the Fund. These doubts reflect in particular the following concerns:

- Linking Fund financing to specific indicators or triggers would shift the Fund's focus from the overall balance of payments to specific aspects of external payments problems;

- It could weaken the judgmental approach to the assessment of existing adjustment and financing needs;

- Contingency mechanisms would introduce a greater degree of automaticity in Fund financing (whereas the current CFF review clearly aims at reducing such automaticity);

- Like any insurance against risks, such mechanisms could raise moral hazard problems both on the part of borrowers and creditors--or to put it in Mrs. Ploix's words, they could lessen the (perceived) need for adjustment;

- They could create risks for the design of adjustment programs by encouraging the adoption of unduly optimistic baseline scenarios (thereby probably also complicating program negotiations and reviews);

- Related to the above concerns, and perhaps even more important, such mechanisms could entail that the Fund's basic mandate to foster orderly adjustment and to protect the adjustment path against disruptive developments--that this mandate would be transferred to a special contingent facility thereby shifting the general focus of Fund arrangements toward the pursuit of short-term growth and longer-term development targets;

- The proposed mechanisms could create substantial strains on the Fund's financial and liquidity position, thereby threatening to erode further the quota-based character of this institution.

The above concerns are reinforced by the likelihood that strong pressures might emerge to expand the number of the trigger variables envisaged under the proposed ECF. Wouldn't it be consistent with the logic of the underlying approach to include additional variables, such as external remittances and grants or increases in imports resulting from unexpected shifts in the savings/investment balance in response to structural reforms prescribed by the Fund? What about unexpected external financing needs arising from weather conditions short of natural disaster?

At the same time, Mr. Nimatallah has raised a number of important questions indicating that the variables proposed for inclusion in the ECF might already be too many. In this regard we have serious reservations about the explicit inclusion of interest rates. The implied need for the Fund to make projections for the level and sustainability of such rates raises fundamental concerns inasmuch as such projections could give dangerous signals to the markets. Moreover, explicit compensation for interest rate increases appears difficult to reconcile with the existing debt strategy and the role of the Fund. In the final analysis it would be tantamount to bailing out commercial banks and other creditor groups; it would ease the pressure to contain or reduce interest rate spreads; and, more generally, it would weaken the efforts to tackle the underlying causes of high or increasing interest rates.

Altogether, I wonder whether it would not be more advisable trying to pursue the basic idea of the proposed ECF in the framework of comprehensive program reviews without explicit reference to specific variables while at the same time providing for the possibility, under appropriate safeguards, of a limited increase in the Fund's financial support for stand-by and EFF arrangements.

In conclusion, it appears that the contingency proposals need much further study and examination in order to forestall potentially serious repercussions on the effectiveness of the Fund. While we are prepared to participate in further discussions with an open mind, we probably could not accept any explicit inclusion of interest rates in contingency mechanisms. Moreover, we would have to insist on effective conditionality, as well as on the elimination of the CFF if a separate contingency mechanism were to be created. Otherwise, we would rather opt for maintaining the CFF, perhaps in a modified form along the lines proposed by the staff.

Finally, I am looking forward to an exchange of views on the many remaining issues raised in the statement of the staff representative.