November 17, 1987 - 87/7

Statement by Mr. Finaish on
Review of the Compensatory Financing Facility
Executive Board Meeting 87/156
November 17, 1987

Let me at the outset commend the staff for the high quality and comprehensiveness of the papers before us. I will try to address the issues in the same order as they appear in the main document; but first let me begin with a few general remarks.

As Mrs. Ploix and Mr. Nimatallah have stressed in their buff statements, it is important not to lose sight of the basic function which the CFF is supposed to perform. This is particularly so during a period when the preoccupation with the widespread BOP difficulties of members may have led some to underestimate the constructive role which the CFF continues to play. While it is understandable, and indeed necessary, that we look for ways to strengthen the role of the CFF in supporting adjustment programs to deal with underlying imbalances, it is crucial that we preserve the Fund's ability to provide timely assistance to members experiencing temporary shortfalls in their export income which are caused by exogenous factors.

In trying to improve the manner in which CF purchases are integrated into a Fund supported adjustment program, one should guard against exaggerating the link between the timing of disbursement under the CFF and the motivation of the member to implement the program policies. Presumably members adopt and implement adjustment policies because they believe that such policies are needed to improve their economic and financial performance. If this was not the case, and if the motivation of members was limited only to the Fund's financial support, then the basic premise of Fund-supported adjustment program would need to be re-examined.

One should also guard against excessive preoccupation with the problem of overdue obligations--in this case overdue CF repurchases. This does not mean that the concern about the revolving character of Fund resources is not a legitimate one. Certainly, when financial assistance is provided to a member, a judgement has to be made as to that member's ability to make repurchases when they become due. This, of course, is already being done. But there is little doubt that in the final analysis, the best guarantee for repayment is the member's success in adopting and implementing the needed policies. In many cases, the timely financial assistance provided under the CFF can play a positive role in giving the member the needed cushion in taking strong measures, often in the form of prior action, at the outset of a program. Thus, it could be argued that quick disbursement under the CFF actually reduces the probability of arrears in the future.

Let me turn now to the specific conclusions and modifications recommended by the staff.

Conditionality and Phasing

We agree with the staff that where the underlying BOP position of the member is considered to be sound and the difficulty is essentially related to the export shortfall, access up to the quota limit should be assured.

In cases where the export shortfall is superimposed on underlying imbalances which could be corrected by policy adjustments, we continue to believe that once the member adopts corrective policies which would normally be considered sufficient for an upper credit tranche arrangement, immediate and full disbursement under the CFF should be assured. This would be consistent with the purpose of the facility and would enable the member to make the purchase at the time when it is needed most. In the past there has been a great deal of discussion on the question of phasing of CF purchases, and the staff appears now to have reached the conclusion that some form of phasing could be useful. We are not convinced that the arguments for phasing outweigh those against, and we continue to oppose the phasing of disbursements. However, if the Board's preference is for phasing, we would be prepared to consider it provided that the question of access limits is addressed simultaneously. In our most recent discussion of access limits under the CFF, the staff acknowledged that an argument could be made for raising the quota limits but nevertheless recommended the maintenance of the present limits pending the comprehensive review of the facility. It is still our expectation that the issue of access limits will be addressed at some point in this ongoing review. Although the questions of access limits and phasing are not directly related, they could be combined in a manner which satisfies those who favor phasing as well as those who are opposed to any reduction in the financing available to the member at the outset of an adjustment program. For example, the three-tranche scheme recommended by the staff could be applied with modified limits for the three tranches which correspond to a higher cumulative limit. One possibility could be to set the first tranche at 33 percent of quota as suggested by the staff and to raise the second tranche to the current cumulative limit of 83 percent of quota. The third tranche would then be equal to the increase in the cumulative limit which the Board may agree on.

As to the type of arrangement which can qualify a member to draw on the higher tranches, in our view a SAF arrangement, a first credit tranche stand-by, or an upper credit tranche arrangement approved in principle, should be considered sufficient. What is important is for the member to demonstrate its willingness to adopt the measures needed to deal with its underlying BOP difficulties. In many low income countries, the SAF may be the most appropriate framework for adjustment. Those countries, many of whom are exporters of primary commodities, should not be penalized for adopting the adjustment strategy which best fits their circumstances. Moreover, at a time when the Fund is seeking to enhance the status of--and the available resources to--the SAF, it would be counterproductive to give the impression that the Fund has less confidence in this facility than in stand-by arrangements. As to arrangements approved in principle and lower credit tranche stand-by's, as long as the Fund is satisfied that the policies adopted by the member are adequate, access to the higher tranches should be assured. While we recognize that the adequacy of policies cannot be fully assessed unless the financing picture is clear, we believe that the risk involved does not outweigh the cost of withholding timely assistance to a member which has shown willingness to do its part, and whose policies have been endorsed by the Fund.

Formula for Calculating Shortfalls

The staff has considered a number of alternatives with a view to meet some of the concerns which have been raised by Directors. While we understand some of these concerns, we find all the alternative methods to be inferior to the one currently being used.

For example, applying a deductible factor or projection limits would be too arbitrary. On the other hand, extrapolating past export earnings would be too mechanical and would ignore any information or judgement which the Fund may have on the future course of export prices.

As to the choice between nominal and real calculations of the shortfall, we agree with the staff that the current method should be maintained.

We also agree with the staff that it would be undesirable to limit compensation to shortfalls on account of primary commodities only, since this would, among other things, be discriminatory. Of course one would expect primary commodity exporters to be the most frequent users of the CFF since their export earnings tend to fluctuate more than exporters of manufactured goods. Indeed as the staff paper notes, exporters of energy products, for example, have the highest index of export instability--roughly twice that of the exporters of manufactures.

Over- or Undercompensation in Successive Purchases

We can go along with the staff's proposal of adjusting the compensable shortfall of a second purchase which falls in the projection period of an earlier purchase involving over- or undercompensation. Although we recognize that shortfalls following undercompensation are less likely to occur, we nevertheless consider the question of symmetry as one of principle. We could also consider adjustments to compensable shortfalls which are beyond the projection period of an earlier drawing that has not yet been fully repurchased. However, here too we attach importance to the principle of symmetry between over- and undercompensation.

The Cereal Decision

We are in favor of separating the cereal decision from the CFF both in order to simplify its administration and to increase its potential usefulness. We are not fully convinced that a joint access limit is warranted, and therefore our first preference is for separate facilities with separate access limits. If the Board did not favor the establishment of a separate cereal facility, we would support the elimination of the 3-year rule as a second best alternative.

Other Issues

On the whole, we find the current method of determining the responsibility for the shortfall to be largely satisfactory. We would, of course, welcome any possible improvements in the staff's analysis of the responsibility for the shortfall in individual cases, including the role of the exchange rate. One should keep in mind, however, that what is relevant here is not the trend of exports but the shortfall from that trend. Thus any attempt to quantify the contribution to the shortfall of a particular policy variable, such as the exchange rate, is likely to prove almost impossible. In the final analysis what is crucial is the judgement that the shortfall is or is not largely due to factors beyond the member's control.

Regarding the import contents of exports, we agree with the staff that the current procedure should be maintained both for conceptual as well as practical considerations.

Concessionality

During our discussion last spring we noted with interest the proposal outlined by Mrs. Ploix to improve the terms of compensatory financing provided to low income countries, and thus increase the accessibility and usefulness of the facility to a group of countries which are particularly vulnerable to fluctuations in export income. We welcome the staff's analysis of this proposal, including the amount of resources which would be needed to make CF money more concessional. We hope that this proposal will receive enough support from other industrial countries. If such support did not prove possible at this time when the efforts are concentrated on enhancing SAF resources, the matter could be considered again at a more appropriate time in the future.

Contingent Use of the CFF

The staff has provided a useful initial discussion of how to enhance the role of the CFF in support of adjustment programs. On the whole we found the staff's analysis broadly satisfactory, although a number of questions on modalities have not been fully addressed by the staff. Presumably this will be done at a later stage after assessing the Board's reaction to the idea of using the CFF for program contingencies. Mr. Dallara has also provided a useful elaboration on the U.S. proposal which was made during the Annual Meetings to establish a broader contingency mechanism for Fund-supported programs. Here too there are a large number of operational questions which need to be examined carefully, as is amply shown in the staff's statement 87/274. In our view it would be premature to comment on all those issues at this time. First, because the staff has not yet had the chance to examine them in full; and second, one would hope that today's initial discussion of the contingency mechanism will enable the staff to narrow down the issues and options to a manageable level so that a more focused Board discussion can take place at a later stage.

At this time I will, therefore, limit myself to a broad outline of our views on the question of contingencies.

We strongly support the idea of building into Fund-supported programs a mechanism which enables members to meet contingencies brought about by exogenous factors. In many cases, adjustment programs provide very little room for maneuver which makes them quite vulnerable to such factors. In our view, any procedure that increases the ability of a program to withstand external shocks would be very helpful in reducing the likelihood of interruptions which often prove difficult to overcome.

The staff has limited its discussion to one type of contingency, namely a shortfall of exports from their expected levels. This is, of course, understandable since the issue is being addressed within the framework of the CFF which is basically concerned only with export shortfalls. The G-24 and U.S. proposals on the other hand are much wider in scope, as they cover a much broader range of contingencies.

While we find attractive many of the elements of the U.S. proposal, we fail to see the logic for the suggestion that the proposed ECF should replace the existing compensatory facility. The two facilities clearly perform different functions. If the ECF were to replace the current compensatory facility, then the Fund would not be able to provide assistance to members experiencing temporary shortfalls but whose policies were basically appropriate. Even in those cases where a Fund-supported program is in place, a shortfall from a medium-term trend--which is currently compensable under the CFF--would not entitle the member to draw on the ECF as long as the shortfall was not associated with an error in the export forecast. As these examples indicate, situations can arise where a legitimate need for quick disbursing Fund assistance will not be met under the ECF.

Given the separate objectives and functions of the two facilities, the contingency mechanism proposed by the U.S. warrants in our view a separate discussion, perhaps outside the current review of the CFF. It would still be possible, of course, to consider the merits of establishing a joint access limit for the two facilities, although at this time we are inclined in favor of separate access limits.

As to the staff's own contingency proposal, we find most of its elements to be broadly reasonable, although as I stated earlier it is much narrower in scope than the mechanisms proposed by the G-24 and the U.S. We are in broad agreement with the staff's views on coverage, reversibility and cooperation with the Fund, but there are clearly many other questions on modalities which need to be addressed more fully at a later stage.

In conclusion, it is our hope that this ongoing comprehensive review of the CFF and the good deal of interest it has generated will eventually result in a stronger Compensatory Financing Facility, and one which is less subject to the doubts and pressures it has experienced in recent years.