November 17, 1987 - 87/8

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

At the outset, I would like to say that my constituency strongly opposes any modification that would change the special features and the main goal of the CFF. We also strongly oppose any change that is aimed at linking drawings under the CFF to drawings under other facilities, thus increasing the conditionality associated with the CFF.

The CFF has unique features that make it very appropriate to perform its stabilizing role associated with balance of payments difficulties resulting from temporary shortfalls in export earnings. Experience has shown that it has performed that function well. If any change is needed in this facility it should be more in the direction of increasing the scope and access of member countries to the facility.

Mrs. Ploix and Mr. Nimatallah have reviewed the purpose and function of the CFF in their very informative buff statement and they have emphasized its unique features. They have convincingly made the case that these special features: low conditionality, simplicity and quick disbursement, must be preserved. I share those views and will, therefore, not go over these arguments again.

I shall now turn to the different issues that are covered in the paper.

On phasing and conditionality, I must say that I was disturbed by the staff's approach. After stating the views expressed by Executive Directors at our previous meeting on the CFF, and reminding us in the first paragraph of EBS/87/165 that the consensus at the Board meeting was that the basic features of the facility should remain unchanged, the staff then proceeds to make suggestions aimed at changing these basic features. The staff describes ways to increase conditionality and the possible ways that a phasing of purchases may be introduced while in supplement I, Annex II after an empirical analysis of instability associated with shortfall earnings, the staff concludes on page 14, "For most of these countries, phasing leads to considerably increased instability when compared to unphased access". Further down on the same page, the staff writes, "The main conclusion to be drawn from the above findings is that the CFF has performed a clear role in stabilizing fluctuations in foreign exchange earnings of developing countries. The reason for this has been the availability of substantial compensation close in time to shortfall in earnings.". It is then quite surprising to find the staff describing in the main paper, a system that contradicts its own findings. It is unfortunate that so much resources are used to develop these schemes and scenarios when it is not evident at all how they will improve the facility.

Moreover, I fail to see how a system of phasing would better safeguard the revolving character of Fund's resources. It is often argued, and without much proof, that frontloading undermines the incentives for a country to follow through on its adjustment program. In fact it is the opposite that may be true. It is the availability of the right amount of financing at an early stage that may reinforce the incentive to adjust. We should keep in mind that future economic growth is dependent on today's investment and very often countries have had to cut down much needed imports because of temporary shortfall in earnings and thus adversely affecting their growth potential.

On the issue of a formal linkage between drawings under the CFF and drawings under other facilities that is being suggested, I must say that they would be unacceptable as they go against the spirit of the 1983 guidelines on cooperation. As was mentioned by many Directors, including myself, during the last Board discussions on CFF, the guidelines do not formally establish a linkage between conditionality under the CFF and that under other facilities. Furthermore, as made clear in those guidelines, the existence or adoption of an arrangement is not a prerequisite for use of Fund resources under the CFF and it has not been demonstrated that there is any need to change them. Moreover, linkages will remove the most important feature of the CFF, that is, it will remove its quick-disbursing character, thereby interfering with the timing of CF assistance that should take place at the time of the shortfalls. From the staff paper and the previous one, the conclusions that one can draw is that it is the linkage that has been drawn in practice that is preventing more countries from drawing under this facility. To me it is very clear that the change that we need goes in the opposite direction to what is being proposed. In fact the usefulness of the CFF would be greatly enhanced, if purchases were made proportional to actual shortfalls instead of being a proportion of quotas.

With regard to the emergence of overdue obligations in relation to CFF drawings, Mr. Nimatallah has demonstrated in his buff statement that, "The bulk of overdue payments on account of CFF drawings occurred in cases where countries had stand-by or other Fund-supported programs in place at the time of the CFF purchase." Linking the CFF to a SBA, therefore, does not prevent overdue obligations. This fact also reinforces our belief that the cooperation requirement does not mean that the country should have a SBA with the Fund. A strong indication that the appropriate measures will be taken to address the balance of payments problems together with normal relations with the Fund should be enough to satisfy this requirement.

Many of the poorest countries would be able to better benefit from the CFF if conditions were more concessional. It is in this regard that we strongly support Mrs. Ploix's proposal to provide low income countries with access to compensatory financing at concessional terms. We feel that this is a proposal worthy of the full support of the Board. A system that would subsidize interest rates for those countries would not be very costly and could be taken care of through a Subsidy

Account. Either scheme as discussed in the supplement would be agreeable to us but to be really meaningful, the terms should be similar to that of the SAF.

On the subject of the creation of a contingency mechanism, we fully support this mechanism in the context of Fund-approved programs. There is a need for such a contingency mechanism and the G-24 has made some excellent proposals on this subject that I agree with. Most importantly, it would be established to support Fund programs in the event of unforeseen exogenous developments. It would be activated if events beyond the control of the authorities were to develop in the course of an adjustment program. As Mr. Ortiz said, during our last discussions on CFF, the contingency mechanism will be forward looking as compared to the CFF which is backward-looking. The CFF is meant to compensate for a shortfall that has already occurred, while the contingency mechanism would be aimed at insuring against unforeseen exogenous developments. Therefore, the contingency mechanism cannot replace the CFF.

In the buff statement 87/224, the staff has raised some very important issues concerning the functioning of a contingency mechanism. These issues are wide-ranging and would have very important implications on the functioning of Fund programs. More analysis by the staff on the issues raised is needed. I would suggest therefore that these issues be examined at our next Board discussions on program design and conditionality.

On the other issues covered in the paper, our position on them has not changed and I shall, therefore, reiterate them.

On the current method of calculating shortfalls, I do not feel that there is any necessity to change it. Experience shows that it has been generally appropriate for its purpose and has the necessary flexibility. Above all it is simple and practical. The few suggestions that are made by the staff have all some drawbacks which would introduce more complexity to the system without bringing much improvement to the calculation.

On the matter of overcompensation, we continue to believe that this can be easily taken care of by a provision which calls for early repurchase in such a case.

With regard to the cereal decision, our preference would be for a separate facility.

In sum, my authorities do not agree with the thrust of the staff paper which gives the impression that the overriding objective of the present review is to protect Fund's resources at the expense of the equally important objective of helping member countries cope with their balance of payments difficulties arising from temporary export shortfalls. The staff paper also provides us with an interpretation of the 1983 guidelines on cooperation that is unacceptable to my authorities. At a time when world economic conditions are difficult and capital inflows to developing countries have been significantly reduced, we should not be studying ways to make access to Fund's facilities more difficult. Instead, we should try to find ways to improve the flows of resources to developing countries. We need to have a global outlook and our policies should be such that they improve world economic and financial conditions instead of hampering them.