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Statement by Mr. Enoch on the Review
of the Compensatory Financing Facility and
the Proposed External Contingency Facility
Executive Board Meeting 87/156
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I would like to say at the outset that in principle we welcome the US proposals for an external contingent facility. We have ourselves been concerned in the past at the apparent fragility of some Fund programmes to external shocks, and at the uncertainties and difficulties that always accompany a situation when a programme is in difficulties. If these can be ameliorated, it will certainly be to the good. At the same time we have also had reservations about the appropriateness of the CFF to the economic conditions of today. The CFF was introduced at a time when commodity prices were expected generally to move cyclically in the short term around a stable, or maybe upward, trend; today's conditions, where most potential users of CFF have longer-term balance of payments difficulties, are perhaps rather different. I note that Mr Dallara would like to replace the CFF with the ECF. Whilst we would at this stage perhaps see some attraction in such an outcome, we are aware that there is considerable support here for the retention of at least some elements of the CFF, and we are listening to the arguments with interest.

I therefore welcome this session, the informal nature of which seems a very sensible way to begin our consideration of the particular issues before us. I think there are some differences as to what we are actually discussing. It would seem that Directors' interventions will variously focus on the CFF, the ECF, or a mixture of both. For my own part, I think it would be best to focus specifically at the proposed ECF at this stage, given the potential implications of the US proposal for the CFF. We already have a very helpful and detailed staff paper reviewing the CFF; it is important now that similarly detailed work is undertaken on the proposed ECF and on the implications of the new facility for the CFF.

I would propose that work on the ECF be broadly organised in three stages:

(i) first, we need to clearly articulate the rationale for an ECF so as to provide from the beginning definite guidance for the construction of any such facility and for the evolution of operational conventions, and we must confirm, if possible within the context of an analysis of past Fund programmes, what scope there is for contingent financing which can be reasonably quantified and effectively addressed;

(ii) the results of this first stage should throw up, at least implicitly, the outline of the most appropriate mechanism to address the problem, although I will offer some tentative suggestions in a moment;

(iii) finally, in fleshing out the details of an ECF, we must examine how the Fund can accommodate such a scheme: this will involve looking at the implications of the ECF for established facilities, including the CFF, as well as the implications for the Fund's position overall.

The concept of an ECF is attractive. Not least, it would reinforce the precautionary feature to Stand-By Arrangements which is consistent with their original purpose. However, as the staff's buff usefully illustrates, there are many questions to be answered. Mr Dallara's buff statement would seem to provide a broadly-acceptable basis on which to proceed, but there are a number of issues raised in the staff buff on which I would like to comment at this stage.

Looking first at the coverage of the ECF, the choice is between seeking to cover the shortfall in some aggregate, such as the balance of payments, relative to baseline, or the shortfall in certain specified components of the aggregate. If we go for the specified components, we will probably argue which will be in and which excluded. However, it is paramount that the facility should only cover factors outside the individual country's control, and to ensure that is the case it is surely helpful that the particular factors which are likely to be outside the country's control are specified in advance. Specifying these factors carefully might also assist timeliness of response, as the factors can be selected, at least in part, on rapid availability of data. We should not ignore the fact, however, that deterioration in the specified factors may be offset by improvement elsewhere in the balance of payments. In this context it might be possible to take account of the overall position of the country in determining its particular ECF financing needs. And in any case one would wish only to give compensation for the net effect of the unanticipated movements in the specified factors where some have been moving in a positive and some in a negative direction.

Which factors should be included in our lists? I have no problems over the selection of export prices and volumes, provided existing CFF rules apply, nor with import prices or natural disasters. As regards the proposal also to compensate for interest rate fluctuations, my authorities are now prepared to look at this closely. We do share the concerns in this area set out by Mr Nimatallah in his very helpful buff; at this stage, however, we feel that if interest rate compensation is linked to an SBA and has a 12-month time limit on compensation after which rebasing takes place, this could go some way to alleviating the concerns. The problem Mr Nimatallah identifies of the excessive cost of covering interest rate contingencies might be covered by providing only partial coverage. We feel that, if commercial banks could also make parallel provision for more finance when interest rates rise, this would make the proposal much more presentable: we would not wish it to appear that the banks were being bailed out by the Fund. All these are subjects for further study by the staff. But one area which would be unacceptable to us would be for the ECF to operate as a growth contingency mechanism. We do not see that growth should be identified in such a way separate from the various factors, both exogenous and endogenous, which bring, or fail to bring, it about.

On the issues of eligibility, as suggested in the staff buff, if we are dealing with countries which have a Fund programme in place I cannot see that we can avoid working from a baseline scenario. The difficulties of establishing that external shocks are beyond the control of members suggests the need for the ECF to be triggered by reviews rather than some automatic mechanism. Thus, the ECF might be seen as a framework for the rapid identification, assessment and response to external contingencies.

The criterion of co-operation with the Fund must be willingness to undertake necessary additional adjustment measures defined at the time of the review. In principle, this would seem not to exclude countries with enhanced surveillance or shadow programmes. Similarly, it should not necessarily exclude a country with a SAF. On the other hand, a member's need for the concessionality of the SAF might in many cases seem to be inconsistent with the use of market-cost ordinary resources. Maybe instead SAF contingencies could be handled within SAF programmes, and so at SAF interest rates, or perhaps one might rely on the skewed enhancement of the SAF to allow for greater contingencies. Moreover, in principle, we feel that, as with CFFs, some lower tranche ECF drawings could be extended to countries without programmes. Perhaps the staff could look at these points in some detail.

The concept of symmetry is one to which this chair attaches great importance and is one area where the US proposals will need considerably more work. In theory, symmetry could be enforced by higher reserve targets, by reduced foreign borrowings or by reduced borrowings under SBAs. Perhaps one might envisage early repayments from past drawings.

The staff buff also asks about an appropriate level of access. In order to determine this, it would be helpful to examine historical experience, although current access levels will provide an important benchmark and access in individual cases must, as for all Fund resources, be within the repayment capability of members. If CFF is retained and ECF is introduced, there will presumably be trade-offs in the access limits of the two facilities. The phasing of access may be desirable in principle but the precise limits will depend on the level of total access and our review of past experience. The novelty of the ECF suggests that the facility should be subject to frequent review, at least early in its life.

The question of the financing of the ECF and its impact on the Fund's liquidity are issues we will have to throw back to the staff with a request for some illustrative simulations. In response to the other questions in this section of the staff buff, I would note that the ECF should not finance prolonged adverse deviations from anticipated levels of performance. Here, I would support Mr Dallara's suggestion that the assumptions of the baseline scenario only be made for no more than 12 months at a time. The outturn at the end of this period would then become the base for any new baseline scenario in the next period and would therefore incorporate persistent deviations from previously-assumed levels. The question of "moral hazard" is one that to an extent is inherent in all Fund assistance. Our safeguard must be adequate assessment of the exogeneity of adverse developments as well as the requirement for additional adjustment measures.

Finally, Mr Chairman. There are two issues which are in part procedural but which do have substance behind them and which will, I believe, involve us in substantial work in the coming weeks. The first is the extent to which the objectives of the ECF could be achieved without the difficulties inherent in devising a new facility, by instead elaborating on the contingency facilities within existing programmes such as those that were introduced in 1986 for Mexico; and, on the other hand, whether those aspects of the CFF which are undoubtedly of value and to which many chairs clearly attach considerable importance, can be safeguarded within the ECF. The second is whether we do in fact have to choose at this stage between the ECF and the CFF, or whether we could perhaps retain the CFF in some form, perhaps whilst trialling the ECF. I would ask the staff to work on these issues now; we will be interested to read their findings, and will return to these topics at our formal discussion.