International Monetary Fund

# The Review of Facilities for Low-Income Countries

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On September 6, 2012, the Executive Board of the International Monetary Fund (IMF) concluded the Review of Facilities for Low-Income Countries.

## Background

In July 2009, the IMF reformed its facilities for low-income countries (LICs) in order to make the Fund's concessional lending instruments more flexible and tailored to the increasingly diverse needs of its LIC members. The new architecture consists of (i) the Extended Credit Facility (ECF), designed to provide medium-term program engagement and financing for countries facing protracted balance of payments difficulties; (ii) the Standby Credit Facility (SCF), to provide financial assistance and policy support to LICs with short-term actual or precautionary financing needs; and (iii) the Rapid Credit Facility (RCF), which is aimed at providing rapid low-access financing with limited conditionality to meet urgent balance of payments needs. The Policy Support Instrument (PSI) is available to countries that have established broadly sustainable macroeconomic positions and do not generally require Fund financing.

At the same time the IMF also agreed on a package of scaled-up concessional financial assistance to LICs for the period 2009−14. This went along with a doubling of the amount of access that could be provided to each country and a decision to set the interest rate to zero for all concessional lending through end-2011 (later extended to end-2012). The interest rate on the Fund's three concessional financing facilities for LICs is to be reviewed regularly thereafter under a mechanism designed to limit fluctuations of the grant element in the context of global interest rate volatility.

The review is an early opportunity to assess the experience

with the new facilities. This paper represents the first stage of the review, and will be followed by a second paper with specific proposals based on the feedback of IMF Executive Directors. The analysis was based on the observed usage of facilities, program design features, country characteristics, and economic outcomes associated with program usage. It was also informed by staff consultations with member country authorities, civil society organizations, and IMF country mission chiefs.

The review found that the 2009 reforms have broadly achieved their aim of closing gaps and creating a streamlined architecture of facilities that is better tailored to the diverse needs of LICs. Supported by the medium-term financing package to boost the Poverty Reduction and Growth Trust's lending capacity, the Fund was able to mount an effective response to LICs' needs during the global financial crisis. Use of facilities has been greatest among the poorer and HIPC-eligible LICs, and has increased strongly for small and fragile economies. The report also presents new empirical evidence suggesting that longer-term IMF program support has helped LICs support economic growth and build macroeconomic buffers, while short-term financing during the recent crisis helped preserve vital spending and facilitated a rapid recovery.

Looking ahead, the paper highlights four challenges:

- To create a sustainable concessional financing framework—including by securing additional resources to address the large prospective drop in the PRGT's lending capacity after 2014—with a view to preserving the Fund's ability to provide effective policy and financing support to LICs, which will remain exposed to global risks and volatility;

- To make the most efficient use of the IMF's scarce concessional resources by better tailoring access and financing terms to countries' individual needs and capacities;

- To improve the Fund's ability to meet LICs' increased demand for contingent financing and policy support in the context of protracted global risks and LICs' continuing integration into global markets;

- To increase the operational flexibility of IMF facilities in certain areas.

**Executive Board Assessment**

Executive Directors welcomed the opportunity to review the Fund's facilities for low-income countries (LICs). They considered that the 2009 reforms have been broadly successful in closing gaps and creating a streamlined architecture of facilities better tailored to the needs of LICs. Directors welcomed the staff's findings that the Fund was able to respond effectively to LICs' needs during the global financial crisis, and that Fund-supported programs have played a positive role over the longer term in helping countries raise economic growth, reduce poverty, and build macroeconomic buffers and institutional capacity.

**Concessional financing framework**

Directors noted that the central challenge ahead will be to preserve the Fund's ability to provide financial support to LICs in the face of a sharp prospective drop in the Fund's concessional lending capacity after 2014. With demand projected to exceed by a considerable margin the Fund's existing financing capacity even under a low-case scenario, identifying substantial additional resources for the PRGT becomes a priority to secure the PRGT's longer-term sustainability.

Most Directors supported, or were open to, using resources linked to the remaining windfall profits from gold sales as part of a strategy to make the PRGT sustainable, possibly supplemented by contingent measures, including suspension of the reimbursement to the General Resources Account (GRA) for the PRGT's administrative costs and/or bilateral fundraising. Many Directors supported, or were open to, establishing a regular fundraising mechanism. A number of Directors saw the two main options—use of the remaining gold windfall profits and regular fundraising—as complementary, while a few encouraged exploring additional options. Some Directors proposed that consideration be given to eliminating PRGT reimbursement to the GRA for administrative costs. A few others considered that, in the current circumstances of elevated credit risks facing the Fund, the remaining windfall profits should be counted toward the Fund's precautionary balances.

**Tailoring access and financing terms**

Directors underscored that it is important to make the most effective use of the Fund's scarce concessional resources. Noting that current access levels appear broadly appropriate on average, most Directors saw merit in keeping access unchanged in SDR terms when the 14th General Review of Quotas becomes effective, which implies a corresponding decrease in access in percent of quota. A number of other Directors were not in favor of reducing access norms and limits as quotas are doubled, or could support only a less than commensurate reduction, while strengthening efforts to address the long-term resource gap. A few of these Directors expressed concern about a perceived lack of evenhandedness in the proposal and a potential negative effect on the Fund's credibility that could arise in the context of the 14th General Review of Quotas. Directors recognized that access will need to be raised in the future as financing needs increase, based on a careful assessment of projected financing needs and available resources. Some Directors underlined the importance of applying robust and evenhanded PRGT graduation criteria and looked forward to the upcoming review of PRGT eligibility.

Directors saw scope for aligning financing more closely with countries' balance of payments needs. In this context, there was broad support for further work on a cost-neutral approach for allowing contingent tranches that can be activated when unforeseen urgent balance of payments needs arise during an on-track ECF or SCF arrangement. While the financing terms of PRGT loans appear on average to strike the

right balance between concessionality and lending capacity, most Directors saw merit in greater differentiation of financing terms, particularly through greater use of blending. While many could consider interest rate surcharges, a few Directors held the view that interest rate differentiation should not go against the principle of uniformity of treatment.

### Contingent financing

Directors generally saw merit in exploring refinements to increase the flexibility of existing instruments to provide contingent financing and policy support to LICs, rather than creating a new instrument. These could include relaxing timing restrictions on access under the SCF; giving ECF users the option to forego disbursements when the member's balance of payments position improves; and making the design of the PSI more flexible while preserving its signaling function. Directors noted that any modifications should be designed in a manner that limits the need for additional resources and avoids adding undue complexity. A few Directors favored exploring a new precautionary instrument for LICs.

### Design of PRGT arrangements

Directors also generally saw room for improvements to certain design aspects of the facilities—including the proposed refinements aimed at refocusing Poverty Reduction Strategy (PSR) linkages on substance rather than process, in consultation with the World Bank. Most Directors would support, or were open to, the proposals to provide options for ECF arrangements with longer initial durations and increased flexibility in the phasing of disbursements. Most also supported considering the proposal to allow defunct arrangements to lapse in order to free up scarce resources. Some others held the view that the treatment of defunct arrangements should be aligned across GRA and PRGT facilities.

Directors looked forward to the second stage of the review, which will draw on their views expressed today, and allow them to take decisions on specific refinements. The Board will return in the near future to the issue of the use of resources linked to the remaining windfall profits from gold sales as part of a strategy to ensure PRGT sustainability.

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