FOR AGENDA

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December 4, 1992

To: Members of the Executive Board

From: The Secretary

Subject: Compensatory and Contingency Financing Facility (CCFF) - Review of Facility

The attached paper is tentatively scheduled for consideration by Executive Directors on Wednesday, January 13, 1993. A summary appears on pages iii-v. Given the complexity of this facility and in order to expedite the Board discussion, Directors may wish to structure their discussion as follows: (i) general issues related to the facility; (ii) the staff recommendations for the compensatory element; and (iii) the staff recommendations for the contingency element.

A staff meeting with interested Executive Directors or their staff would be arranged to answer questions prior to the Executive Board meeting. This meeting has been tentatively scheduled for 10:00 a.m. on Tuesday, January 5, 1993, Room 12-120B.

Mr. Kincaid (ext. 37356) is also available to answer technical or factual questions relating to this paper prior to the Board discussion.

Att: (1)

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Department Heads

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INTERNATIONAL MONETARY FUND

Compensatory and Contingency Financing Facility (CCFF)--Review of Facility

Prepared by the Policy Development and Review Department

(In consultation with the Legal and other Departments)

Approved by Jack Boorman

December 3, 1992

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Summary

This paper reviews recent experience with the CCFF and recommends a fundamental simplification of the contingency element and certain modifications to the compensatory element. Many key provisions of the facility would be left unchanged, including those related to access, cooperation requirements, and its rate of charge.

I. The Contingency Element

The contingency element is intended to reduce the vulnerability of Fund-supported programs to unexpected external developments. It provides a commitment of Fund financing (additional to the resources available under the arrangement) to help a member adapt its economic policies in the event of adverse shocks affecting prespecified current account variables that are beyond its control. In the event of unforeseen favorable developments in the prescribed variables, "symmetry" provisions apply, and can result in an increase in the target for international reserves or a reduction in the resources available under the Fund arrangement.

Many operational parameters of external contingency mechanisms (ECMs) have been narrowly prescribed and, as a result, the contingency element has proven to be largely unworkable in practice. In particular, the following problems have arisen: First, ECMs define external shocks in terms of deviations of selected variables from baseline projections established at the beginning of a program. There is no provision for subsequent modification of the ECM baseline or the selected variables, even if the underlying program is changed. This has led at times to the existence of two different baseline projections related to the same program, greatly complicating the monitoring and activation of ECMs and weakening their capacity to protect as intended against unforeseen events. Second, performance criteria under the associated Fund arrangement are not adjusted automatically when an ECM is triggered, but instead can only be modified by a decision of the Executive Board. The resulting delays in the adjustment of performance criteria can lead either to Fund financing being provided where there is insufficient adjustment under the new circumstances, or to Fund financing being delayed even though adjustment efforts have been intensified. Third, it was envisaged that additional financing would cover a substantial proportion of the impact of an external shock in the early stages, with the presumption that this financing proportion would decline over time as the corrective impact of additional adjustment measures took hold. While reasonable in principle, this has been complicated to apply in practice, particularly in instances when a country experiences multiple shocks.

A number of Fund arrangements have also incorporated contingency mechanisms outside the framework of the CCFF, through automatic adjustors to performance criteria built into the arrangements. These "in-built contingency mechanisms" (ICMs) have covered both current account and capital account variables, whereas ECMs cover only current account variables since

providing financing for capital account deviations is not permitted under the CCFF. ICMs do not provide for additional Fund financing in the event of an adverse shock. Nevertheless, because ICMs are more flexible and better protect timely availability of Fund resources under an arrangement, they have been used more widely than ECMs. Although ICMs confront some of the operational complications of ECMs, experience has not shown major shortcomings in their application; rather, the experience with ICMs suggests possible avenues to simplify ECMs.

The staff considers that the basic purpose of the contingency element--to help sustain adjustment efforts in the face of unexpected external developments--remains important in the design of Fund-supported programs; therefore, it recommends that contingency mechanisms under the CCFF be retained but in a simplified form that would make them more readily usable. The operational modalities of contingency mechanisms would continue to be prespecified under the Fund arrangement approved by the Board. Recommended changes include: (i) allowing baselines (and covered variables) to be modified with Board approval, so as to coincide with changes in the baseline for the associated Fund arrangement; (ii) incorporating automatic adjustors to performance criteria; and (iii) permitting many operational parameters (e.g., financing proportions and thresholds) to be determined on a case-by-case basis based on general principles, rather than being rigidly defined to apply across all cases as at present.

While an adverse shock would trigger an automatic downward adjustment in the program target for international reserves, additional Fund financing under the CCFF could be provided to "top up" gross international reserves that may already have been drawn down in accordance with the automatic adjustment to the reserve target. The release of such financing would require a Board review to determine, inter alia, whether the program remained viable. Contingency financing would continue to be limited to the amount by which the actual overall balance of payments need deviated from the amount targeted under the program. There also would continue to be symmetrical treatment in the case of a favorable shock: the reserve target would be automatically adjusted upward, and the Fund would continue to have--as a less preferred option--the possibility of reducing the amount of the arrangement.

The proposed changes are intended to eliminate any meaningful distinctions between the two types of contingency mechanisms for current account variables. The staff proposal would not, however, preclude the continued use of contingency mechanisms without CCFF financing, as there may be cases where understandings on program adjustments in response to external shocks are considered important but contingent financing is not required. ICMs could also continue to be used for contingencies related to capital account variables.

II. The Compensatory Element

The compensatory element of the CCFF provides financing to compensate for export shortfalls or excesses in the cost of cereal imports that are temporary and are due to circumstances beyond the control of the member. The paper examines the compensatory element in light of questions raised by Directors and the experience with recent modifications to this element. The modifications proposed are summarized briefly below.

1. To facilitate prompt access to compensatory financing, the Executive Board in November 1990 extended from six to twelve months the period for which estimated data on merchandise exports could be used in calculating export shortfalls. Since then and with the introduction of the temporary oil element, the incidence of overcompensation and of prompt repurchase expectation has increased markedly. The staff therefore recommends that, in the future, compensatory purchases be phased whenever nine months or more of estimated data are used. This would allow a possible adjustment in the amount of compensation once sufficient actual data became available.

2. During the past ten years, nearly half of the prompt repurchase expectations that arose were not fulfilled in the required 30 days. The staff proposes that, under such circumstances, consistent with the Fund's policy in other areas, a member's right to make further purchases under any existing arrangement would be automatically suspended and management would not recommend approval of a new request for Fund resources, pending fulfillment of the repurchase expectation.

3. The import content of exports would be netted in computing an export shortfall, in cases where the import content of exports is large, direct, and easily measured (e.g., exports of refined petroleum products using imported crude).

4. Access to compensatory financing could be limited on capacity to repay grounds in situations of concurrent requests for compensatory financing and for a Fund arrangement.

5. In the case of former CMEA members that currently do not qualify for compensatory financing related to export shortfalls (because such shortfalls are judged to result from systemic changes), the staff proposes case-by-case determination of when such financing might again be appropriate.

Certain other issues (including the timing of compensatory requests, determination of compensable amounts, and the procedures for final calculations under the early drawing procedure) are also examined, but no changes are proposed.

The paper proposes that the next review of the CCFF take place in three years. If unforeseen issues arise, this timetable could be advanced.

I. Introduction

The Compensatory and Contingency Financing Facility (CCFF) was established on August 23, 1988, combining the former compensatory financing facility (CFF) and the cereals component with new provisions for contingency financing. The CCFF was modified in July 1989 and July 1990, primarily to simplify the operations of its contingency element, and in November 1990 to provide readier access to compensatory financing for countries affected adversely by the Middle East crisis. 1/ At the time of the completion of the last comprehensive review of the CCFF on July 16, 1990, it was agreed that there would be a further review of the operations of the facility by July 16, 1992. 2/ Subsequently, the period for completion of this review was extended until December 31, 1992. 3/

This paper reviews experience with the CCFF operations during the period since January 1990. 4/ For the compensatory element, the focus is on the modifications made to the facility in November 1990. 5/ The review of experience with contingency mechanisms for current account variables touches not only on external contingency mechanisms (ECMs) that have been attached to Fund arrangements under the CCFF, but also on contingency mechanisms outside the CCFF that are built into Fund arrangements using adjustable performance criteria (referred to as inbuilt contingency mechanisms, ICMs). 6/ The staff suggests a number of modifications to the compensatory element and substantial changes in the operational modalities for contingency mechanisms. Certain key provisions of the facility would be retained, including those related to overall access; access available under the contingency and compensatory elements including the optional tranche;

1/ Modifications to the compensatory element included changes in the early drawing procedures; expansion of coverage for shortfalls on earnings related to services (other than investment income); and the temporary introduction of compensation for members with excesses in oil import costs.

2/ "Modification of Compensatory and Contingency Financing Facility Decision" (SM/90/115, Supplement 1, 7/20/90).

3/ "Review of the Compensatory and Contingency Financing Facility--Postponement of Deadline" (EBD/92/131, 6/25/92).

4/ The experience through end-1989 was summarized in the previous CCFF review paper, "Review of the Decision Relating to the Compensatory and Contingency Financing Facility" (EBS/89/206, 10/30/89).

5/ Two staff papers have already reported on operations under the oil element: "Report on Operations Under the Oil Element of the Compensatory and Contingency Financing Facility" (EBS/91/49, 3/19/91); and "Recent Experience in Eastern Europe with the Oil Element of the Compensatory and Contingency Financing Facility" (EBS/92/23, 2/11/92).

6/ Experience with both types of contingency mechanisms was summarized in the previous CCFF review paper (EBS/89/206, 10/30/89); in-built contingency mechanisms were reviewed more recently in "Selected Operational Issues Related to the Use of Fund Resources" (EBS/91/108, 7/3/91).

cooperation requirements; and the rate of charge on the use of resources under the facility.

The proposed changes in the compensatory element include: (i) the introduction of phasing in conjunction with the early drawing procedure; (ii) a provision that a member that fails to fulfill a prompt repurchase expectation resulting from overcompensation would not be permitted, until the expectation was met, to use further Fund resources; (iii) the netting of the import content of exports in certain circumstances; and (iv) the scope of the capacity to repay provision on CCFF access in cases of a concurrent request for a Fund arrangement. Several other aspects of the compensatory element also are reviewed, but no changes are proposed in these areas.

The paper also describes problems that have arisen in the operation of contingency mechanisms under the CCFF. At the time of the last conditionality review, most Executive Directors considered that experience with in-built contingency mechanisms outside the CCFF--involving automatic adjustment of performance criteria--had been encouraging. A few Directors suggested that the possibility be explored of protecting programs exclusively through the use of in-built contingency mechanisms. Directors requested that these issues be revisited at the current review of the CCFF (Buff 91/144, 8/13/91).

The staff thinks that the basic purpose of the contingency element--to help sustain adjustment efforts in the face of unexpected external developments--remains an important issue in the design of Fund-supported programs. However, notwithstanding the previous attempt at simplification, ECMs under the CCFF have generally proved unattractive to members owing to certain rigidities and complexities--particularly related to fixed baselines; to the absence of automatically adjustable performance criteria; and to a complex pattern of financing and adjustment. In contrast, experience with ICMs, which share many of the basic operational issues of ECMs, has not pointed to major shortcomings and their flexibility has suggested possible avenues to substantially simplify the contingency element of the CCFF.

The objective would still be to provide members with firm assurances of the circumstances under which contingency financing would be available. The staff would propose, however, that contingency mechanisms under the CCFF would henceforth operate through automatic adjustors to performance criteria prespecified in Fund arrangements. Meanwhile, the detailed provisions in the CCFF Decision that have resulted in unworkable rigidities would be deleted and broad policy guidance (modeled on experience with ICMs), would be substituted. These modifications would permit ECMs to be tailored more effectively to the individual country's circumstances and allow Fund financing under an arrangement to proceed undisturbed in the face of adverse developments as long as the country has adapted policies appropriately. Other features of the contingency element would be retained such as the access limits, the provision related to double compensation, and basic tenets of the activation procedure for purchases (e.g., the requirement of a

Board review to disburse additional Fund resources, and the limit on Fund financing to the size of the deviation in the overall balance of payments).

Sections II and III, respectively, summarize experience during 1990-92 with the operations of the contingency and compensatory elements; examine issues that arose; and provide staff recommendations. A separate background paper provides details on the recent experience with ECMs and ICMs, along with additional material on the compensatory element of the CCFF.

In light of the Executive Board discussion of the issues raised in this paper, it may be necessary to amend the CCFF Decision. 1/ In that event, the staff would submit a proposed draft decision to the Executive Board; the present operational guidelines for the CCFF would be changed accordingly.

II. Operation of Contingency Mechanisms

1. Introduction

External contingency mechanisms under the CCFF are intended to help reduce the vulnerability of Fund-supported programs to unexpected external developments. 2/ Toward that end, additional Fund financing would be made available to assist a member adapt its economic policies to unexpected developments in prespecified current account variables that are beyond its control (e.g., prices of imported petroleum). Financing provided under an ECM covers a proportion of the net loss in foreign exchange earnings stemming from an unfavorable deviation (from the projected path) in these prespecified variables. Deviations in the covered variables are measured relative to a fixed baseline projection of prices and volumes established when the ECM is approved. The ECM is triggered once cumulative net deviations in the covered variables exceed a prespecified threshold (normally 10 percent of quota).

A mix of financing and adjustment--the financing proportion--in response to unexpected developments is specified ex ante. When an adverse external shock occurs, policy adaptations are expected to be undertaken immediately; since normally the corrective impact of policy adaptations would need some time to take hold, a higher proportion of financing relative to adjustment would result initially. As the impact of adjustment measures phase in during subsequent quarters, the financing proportion would be

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1/ The full text of the CCFF Decision can be found in the Fund's Selected Decisions (17th issue) on pages 106-132.

2/ ECMs may be attached to Fund arrangements, including under the SAF or ESAF, in cases where the program supported by the arrangement meets the criteria for the use of the Fund's general resources in the upper credit tranches.

expected to decline. This pattern of increasing adjustment and decreasing financing has been referred to as declining financing proportions.

Access under the contingency element for a given Fund arrangement is limited to no more than 70 percent of the access of the underlying arrangement with a maximum access under the contingency element of 65 percent of quota (including the optional tranche). 1/ Adverse external developments may require additional financing beyond that provided by the Fund and in such circumstances, Fund resources would be disbursed only if the adjustment program continued to be adequately financed. 2/ Favorable deviations--such as an unexpected increase in export prices--could trigger symmetry provisions; in that case, the Board could decide to increase the international reserve target above the level initially set under the Fund-supported program. The maximum reserve increases would be limited to the amount of financing that would have been made available under the contingency element if the deviation had been unfavorable, rather than favorable. 3/ Activation of either contingency financing or the symmetry provision would occur in the context of a review by the Executive Board.

An ECM is intended to encourage a member to take additional measures to sustain its adjustment effort by giving the member greater confidence through formal and explicit assurances of the circumstances under which additional Fund financing would become available, or to adhere to an appropriate adjustment path even in the event of more favorable circumstances. To lessen uncertainty as to whether the conditions related to additional Fund financing have been met, the features of an individual ECM must be specified in advance as clearly as possible. After considerable discussion at the time the CCFF was created, the Executive Board decided to define in detail a common set of specifications for the modalities of contingency mechanisms that would be applicable to all cases. 4/ These specifications were incorporated into the CCFF Decision and the associated operational guidelines. It was recognized that a tradeoff existed between such detailed and broad prespecification of the modalities and the expressed

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1/ All references to quota in this paper refer to quotas or access limits that were in effect prior to the increases in quotas under the Ninth General Review.

2/ For example, if a country had commercial bank debt at variable interest rates and international interest rates were a covered variable under an ECM, an increase in international interest rates above the baseline projection could also warrant additional financing from commercial banks.

3/ While a reserve increase is the preferred option, the Board could also decide to reduce the amount of the associated Fund arrangement subject to the same limit.

4/ See paragraph 19 of the CCFF Decision; see also "Final Version of the Chairman's Summing Up of the Discussion on the Compensatory and Contingency Financing Facility Concluded at Executive Board Meeting 88/105, 7/15/88" (Buff/88/133, 7/15/88); this summing up has been annexed for ease of reference.

desire of Executive Directors to avoid creating an unduly rigid and complex system. Experience has shown however, that the resulting compromises did not yield an easily workable contingency element.

A number of Fund arrangements have also incorporated contingency mechanisms outside the framework of the CCFF, in the form of automatic adjustments to performance criteria triggered by exogenous deviations in one or more key current account variables. Such in-built contingency mechanisms (ICMs) had been in some cases part of program architecture even before the establishment of the CCFF; indeed, they helped stimulate calls for a permanent contingency facility and provided a reference point for discussions on possible modalities. These ICMs have continued to be utilized after the creation of the contingency element of the CCFF.

In general, use of contingency mechanisms has not become the norm. During 1990-92, over one quarter of annual programs supported by the Fund have utilized some form of contingency protection for current account variables (27 contingency mechanisms--ECMs and ICMs--out of 103 annual programs). 1/ This average, however, masks markedly different patterns of usage among different types of Fund arrangements; contingency mechanisms of one kind or another were incorporated about one third of programs under stand-by or extended arrangements (including Fund-monitored or rights programs), compared with sparse use of contingency mechanisms under SAF/ESAF arrangements.

ECMs have been attached to ten annual programs supported by upper credit tranche arrangements during the period under review (Table 1). Interest in the facility (notably on the part of members in Eastern Europe) surged during 1990-91 against the background of oil price volatility and following the simplification of the contingency element in July 1990. However, while nine ECMs were approved in 1990-91, there has been only one in 1992 associated with an extended arrangement approved earlier. During the same period, ICMs covering current account variables were incorporated in a total of 17 annual programs--ten annual programs supported by upper credit tranche arrangements, four annual ESAF arrangements, and three annual rights accumulation programs (Table 2); one member (Algeria) had both an ECM and an ICM operating concurrently.

1/ While ECMs may cover only shocks to current account variables, ICMs have included both current and capital account variables. In order to focus on lessons that are directly relevant to the operations of the CCFF, this paper has focused only on covered current account variables of ICMs. In some ICMs, automatic adjustments to performance criteria are triggered by current account variables alone, but once triggered the actual adjustments to performance criteria also automatically take into account deviations in capital account variables.

2. Operational problems with ECMs

Given that interest in the contingency element of the CCFF appears to have subsided once again, while there has been substantially greater use of contingency mechanisms outside the CCFF, area department staff were surveyed concerning the attitudes of country authorities. This survey suggests that ECMs are perceived as too inflexible (in terms of their specification and operation) to be tailored to a country's specific situation. In addition, experience with ECMs since the last review has highlighted significant problems related to 1/: (a) fixed baselines; (b) the non-automaticity of adjustments to performance criteria; and (c) declining financing proportions. The complexity and technical nature of the following presentation fairly represents the difficulties the staff has encountered in explaining to country authorities the requirements of the contingency element and in designing acceptable and effective contingency protection on the basis of present guidance. Executive Directors who are already convinced of the need to substantially simplify the contingency element may wish to move directly to the staff's proposals in Section 4.

a. Fixed baselines

ECM baselines are generally established for a period of 12-18 months and cover a few key external variables; there is no provision for a subsequent modification of either the coverage of variables or the baseline projections for the covered variables (Buff/88/133, 7/15/88). 2/ This policy has complicated the monitoring and activation of ECMs, particularly in cases where performance criteria under the associated Fund arrangement have been set for only the first half of the program period or were subsequently modified at a program review. 3/ Performance criteria established subsequently incorporate new information that has become available but such information cannot be reflected in the ECM baseline as it must remain fixed. The adoption of a new program baseline (but not a new ECM baseline) with new or revised performance criteria, has resulted in the need to monitor separately the ECM and the revised program. This separate monitoring process has imposed an additional burden on the authorities and staff and has reinforced the perception that there is insufficient linkage of the ECM to the underlying arrangement.

1/ Experience with ECMs prior to 1990 was summarized in the last CCFF review paper (EBS/89/206, 10/30/89).

2/ During the review period, only Hungary had its ECM modified owing to an inability to collect reliable price and volume data for monitoring non-oil trade with non-CMEA countries. Consequently, the Board agreed to delete the relevant covered variables at the mid-term review (EBS/91/138, 8/20/91); however, the baseline for the remaining covered variables remained fixed.

3/ For nine of ten annual programs with associated ECMs during 1990-92, some performance criteria were either specified after the ECM was established or were modified during the ECM baseline period.

With dissimilar ECM and program baselines, complications have arisen over time in determining whether the ECM has been triggered and assessing how its provisions should be implemented. The CCFF Decision requires that, in the application of symmetry or financing provisions, allowance is to be made for possible offsets from uncovered current account variables and for a deviation in the overall balance of payments from the program target. These calculations should be performed relative to the ECM baseline and original program baseline (and not relative to the revised program baseline), but this is not always easy to do. In some cases, such calculations have not been possible because the quarterly pattern of the current account was not specified nor were quarterly targets for net international reserves established at the outset for the full period of the ECM baseline; the latter is the case particularly where the outcome of policy measures was considered unusually uncertain or full policy specification was not possible, say, because the budget cycle would begin midway through the Fund arrangement.

In other cases, modifications to the targets for net international reserves, owing to factors distinct from the ECM operation, have been in the opposite direction to that suggested by the ECM and/or such program modifications have overwhelmed the changes indicated by the ECM. 1/ Such modifications in the program's targets for international reserves could effectively either undo or intensify the effects of activation of the symmetry provisions under the ECM. There has also been a need to record separately the factors causing various changes in the balance of payments in order to distinguish changes that were undertaken to comply with the provisions of the ECM from those that were implemented in response to evolving program requirements.

The existence of two baselines--an ECM and a revised program baseline--can also change the nature of the contingency protection provided to the program. Baseline projections are intended to be free initially from systematic bias so as to avoid a disproportionate occurrence of either favorable or unfavorable deviations. A change in the program baseline--say, owing to a favorable export price development that is expected to persist relative to the already established ECM baseline--could introduce a systematic bias into the contingency protection provided over the remaining program period; as a result, potential triggering of the ECM relative to the new program baseline could be more likely in one direction (e.g., international reserve accumulation) and correspondingly less likely in the opposite direction (e.g., Fund financing). Thus, relative to the new program baseline projections, there might be a disproportionate likelihood

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1/ For example, favorable developments in the covered variables may result in actual international reserve accumulation exceeding the maximum amount required under the symmetry provisions of the ECM; however, at a mid-term review, the program target for international reserves could be increased above this maximum to reflect the greater scope for reserve accumulation.

of triggering a favorable deviation under the ECM and a need to increase international reserves above the program targets.

A fixed baseline was intended to provide firm assurances to the member that the circumstances under which financing or symmetry provisions were applicable would remain unchanged throughout the arrangement period. This objective has not been fully achieved through a fixed ECM baseline, however, because the program baseline and targets could still be modified and thus, effectively undo the effects of the ECM provisions by altering the international reserve targets. If a rationale for a contingency mechanism is to assure forward-looking protection for a program that is free from systematic bias, contingency and program baselines should be identical at all times.

b. Non-automaticity of adjustments to performance criteria

Under the symmetry provisions, a favorable deviation above the threshold would require, as a first option, an upward adjustment to the performance criteria, or targets, for a member's international reserves. As noted above, performance criteria are not adjusted automatically under ECMs, as they are under ICMs, but are instead modified by a decision of the Executive Board, normally in the context of a program review. The symmetry provisions of ECMs have been triggered in three cases since 1990 on account of favorable developments in covered variables, leading in each case--ultimately--to an upward adjustment in the targets for net international reserves. However, because of the lapse of time before the Executive Board review, the test date for the performance criteria had passed in each instance and, given the inability to adjust performance criteria retroactively, the performance criteria for the quarter in which favorable deviations occurred were not adjusted.

The non-automatic adjustment of performance criteria has been a problem in these cases. Delays in adjusting the performance criterion related to international reserves could have resulted in a member making a drawing under an arrangement even though actual reserves might not have increased as could be called for under the symmetry provisions of the ECM. Thus the member could have relaxed adjustment policies inappropriately in response to unexpectedly favorable external developments, while still observing the unmodified performance criterion under the arrangement. By contrast, in the event of an unfavorable deviation from the ECM baseline, a member could find itself unable to draw under its Fund arrangement owing to nonobservance of performance criteria because modification of those performance criteria (in accordance with the CCFF) was not approved by the Executive Board prior to the relevant test date. (Of course, in such cases, the Board could grant a waiver of the applicable performance criteria.)

In part, this relatively slow activation procedure for modifying the Fund arrangement stems from a desire by the Executive Board in the early experimental stage of this facility to have a Board review of the circumstances of each case. However, at the time the CCFF was established it was understood that at some future date more expeditious procedures could apply. In particular, some Board reviews might occasionally be conducted for the activation of a contingency mechanism on a lapse-of-time basis. In addition, in some exceptional cases where the link between additional financing needs and the relevant contingencies and policy actions could be specified in advance with sufficient precision, the Executive Board could give advance approval for triggering the contingency mechanism and disbursing additional financing without further Board review (Buff/88/133, 7/15/88, Section 2).

While under ECMs the adjustment to be made in the reserve target for the quarter of activation is relatively clear, the appropriate adjustment for future performance criteria is uncertain; a variety of possibilities exist, depending on whether the deviation in a covered variable is expected to be reversed, persist, or intensify over time. In any event, the actual outturn could be different from the revised targets, requiring further waivers or modifications of performance criteria. Problems associated with nonautomaticity of adjustments to performance criteria could thus re-emerge. These difficulties could be avoided in part through the inclusion of an ICM coupled with the ECM as was the case for Algeria; however, two overlapping contingency mechanisms are clearly an undesirable complexity. The staff would therefore recommend that contingency mechanisms under the CCFF be carried out through prespecified, automatic adjustors to performance criteria.

c. Financing proportions

Financing proportions in contingency mechanisms determine the extent to which the calculated deviations in covered variables lead to additional financing or further policy adjustment. While the CCFF Decision itself does not require it, the relevant summing up (Buff/88/133, 7/15/88, Section 6) established a strong presumption that financing proportions under ECMs would decline over time. The rationale for declining financing proportions was that, as the policy measures to respond to an external deviation have full impact only over time, it generally would be appropriate to finance a relatively high proportion of the balance of payments impact in the initial period, with smaller financing proportions thereafter. This straightforward proposition, however, becomes complex to apply if a second, larger shock is experienced in a subsequent quarter. In this situation, the net sum of deviations in any quarter needs to be partitioned between the two shocks in order that a different declining financing proportion be applied to each shock. This complexity would be further compounded by multiple shocks. The staff would question whether the finetuning of financing proportions has been worth the added complexity associated with its application.

Financing proportions have varied considerably across ECMs (and ICMs). Declining financing proportions have been included in all but one ECM approved to date, but in the interest of simplicity these proportions generally have not declined monotonically by quarter. Some ECMs have specified a high initial financing proportion in the quarter of activation with lower constant proportions applied thereafter. However, a high initial financing ratio has not necessarily resulted in a high level of financing (or reserve accumulation) in the period of activation, because thresholds also apply in the initial period and these have typically been large relative to the deviations. Although constant financing proportions are simpler, they produce--in combination with a threshold--the somewhat perverse result that, for a given deviation, available financing in the quarter of activation could be smaller than in subsequent quarters.

Constant financing proportions without a threshold (as has been practiced by most ICMs) would avoid the operational complexities associated with declining financing proportions and thresholds. Tradeoffs do exist however between the possibility of providing too little financing in the quarter of activation and an appropriate mix of financing and adjustment thereafter, and the alternative of providing appropriate financing for the initial quarter, which subsequently may involve too much financing and insufficient adjustment. The staff would recommend that the guidance of the Board be amended to normally permit constant financing proportions, and that thresholds be permitted but not required.

3. In-built contingency mechanisms

In designing an ICM for an individual country case, the same basic issues arise that would emerge in specifying an ECM. 1/ Thus, recent experience with ICMs might suggest useful modifications to ECM modalities. The similarity of design issues reflects a commonality of purpose and the fact that in order for ICMs to provide automatically adjustable performance criteria, its modalities must be prespecified in much the same manner as for ECMs. As set out in detail in the background paper, while ICMs and ECMs have in practice shared many of the same basic operational modalities (e.g., thresholds, financing proportions), there is greater diversity among ICMs than for ECMs. The main reason for this greater diversity among ICMs has been that the staff and the authorities are relatively free to tailor an ICM in a more appropriate manner to the member's individual circumstance (including limitations related to data or administrative capacity), while several key operating modalities for ECMs are rigidly determined in the CCFF Decision or in guidance provided by the Board.

Modalities for ICMs have displayed many similarities to those in ECMs (Tables 3 and 4). Both mechanisms have sought to cover key variables of the current account that were beyond the control of the member, easy to monitor, and potentially volatile. ICMs have tended to cover fewer variables than ECMs; current account variables covered by ICMs have generally been those

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1/ Experience with ICMs was reviewed in "Selected Operational Issues Related to the Use of Fund Resources" (EBS/91/108, 7/3/91), and the approach to external contingencies used under SAF and ESAF arrangements was examined in "Structural Adjustment Facility (SAF) and Enhanced Structural Adjustment Facility (ESAF)--Background Information" (EBS/91/110, 7/8/91).

variables (e.g., petroleum prices) that have loomed large in the fiscal accounts, making it easier to pre-specify appropriate adjustments to program targets, particularly the public sector balance, domestic credit expansion (including recourse to domestic credit by the government), and the level of international reserves. Where the impact of possible deviations has been mainly on the private sector, the policy implications have been more difficult to identify and would depend on the private sector's own reaction to the external shock. In such cases, either there has been no attempt to design in-built contingency mechanisms or they have been limited to adjusting performance criteria on net international reserves and net domestic assets.

Both ECMs and ICMs have contained symmetry provisions to adjust international reserves in response to positive deviations in covered variables. Under an ECM, the extent of the adjustment in the target for international reserves in the event of a favorable deviation is limited to the amount of financing that would have been financed under the ECM if the deviation had been adverse. 1/ On the other hand, in the case of ICMs where the scope for adjustment to adverse developments was limited (for example, because of an initial low level of international reserves or precarious external financing situation), the use of international reserves was constrained (e.g., by a cap on cumulative reserve use); however, should a favorable deviation occur, the additional reserve accumulation was not similarly constrained. This asymmetrical approach reflected, on the one hand, the limited possible recourse to reserve use without threatening the program's viability and, on the other, the desirability of reaching an adequate reserve cushion as quickly as possible.

ICMs differ from ECMs principally on the following points. One, ICMs provide for no additional Fund financing; rather, they permit through prespecified automatic adjustments to performance criteria, the drawing down of own or borrowed international reserves below initial program targets to help contend with an unexpected adverse external development in a covered variable. Two, ICMs tend to operate in a more timely fashion. Under ICMs, provided all performance criteria including adjustable ones are observed, Fund financing under the arrangement proceeds undisturbed. Under ECMs, performance criteria do not adjust automatically but remain as specified under the Fund arrangement until there is a Board review to activate the ECM and to waive or modify, as warranted, performance criteria under the Fund arrangement. As for the ECM itself, the Board must assess developments in order to activate contingent financing including particularly developments in uncovered variables that may offset deviations in covered variables; a

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1/ Under ICMs, the only possible action under the symmetry provision has been an adjustment of performance criteria, while under ECMs the symmetry provision may lead to a reduction in the amount of the Fund arrangement. However, in all four cases thus far where the symmetry provision has been activated, the Board has decided not to reduce the amount of the Fund arrangement.

similar process could occur under ICMs--after the automatic adjustments that were prespecified have been effected--in the context of setting new, or modifying existing, performance criteria.

Three, for an ECM, the baseline projections may not be modified during the baseline period of 12-18 months and specified covered variables are required to remain unchanged throughout the life of the underlying Fund arrangement. No comparable requirement exists for ICMs; ICM baselines have corresponded to the period for which performance criteria have been specified. Program/ICM baselines and program performance criteria have been established or modified at program reviews to incorporate more recent data and revised projections. The Board has relied on the staff to recommend modifications that are appropriate from the standpoints of both the member and the Fund. Four, most ICMs have operated based on constant financing proportions without a threshold. This approach has avoided the operational complexities associated with declining financing proportions. Five, symmetry provisions under ICMs may lead to a strengthening of performance criteria on international reserves, whereas under ECMs, symmetry provisions may also lead to a reduction of the amount of the Fund arrangement.

4. Staff proposals

To address the difficulties that have arisen in the operation of ECMs, two alternatives may be considered: (i) the elimination of the contingency element of the CCFF; or (ii) major simplification of the contingency element to make its operational modalities less rigid (and modeled on the experience with ICMs).

Some Executive Directors have suggested that the contingency element of the CCFF could be eliminated, thereby streamlining somewhat Fund operations. Elimination of the contingency element would mean that Fund contingency protection thereafter could only be provided through ex post augmentation of arrangements, coupled with waivers and modifications of performance criteria. In considering this possibility, it is perhaps pertinent to recall the initial objective of the contingency element--to help strengthen the member's resolve to persevere in its adjustment effort through firm assurances concerning possible additional Fund financing. An expression of willingness by the Fund to consider augmentation if the need should arise in the course of an arrangement could be provided at the time of approving the arrangement itself, but would not offer the same degree of ex ante assurance as a formal contingency mechanism. 1/ Furthermore, it would not formally embody the symmetry principles to further consolidate adjustment should external conditions turn out better than anticipated.

1/ Fund financing to deal with an exogenous shock could then be provided as part of the adaptation of the program within established access limits.

There would also be a need to define access policy for such augmentations which could be a difficult process and could essentially reproduce the considerations that resulted in the access levels under the contingency element. Retaining the contingency element may avoid reopening these potentially contentious access issues. It also has the advantage from the standpoint of the borrowing member of being outside the framework of access limits related to the credit tranches.

As indicated earlier, a few Directors have suggested that consideration be given to providing contingency protection to programs exclusively through ICMs. However, no ex ante commitment of Fund resources would be associated with such ICMs, an element of contingency protection to which some members have attached importance. In the staff's view, therefore, there is merit in continuing to make available contingent Fund financing under the CCFF.

To date, the Fund has utilized two different approaches to providing contingency protection for Fund-supported programs. On the one hand, ECMs under the CCFF have involved considerable prespecification by the Board of ECM modalities that has greatly limited the scope for adapting these mechanisms to the particular circumstances of members. This rigid specification for the most part has proven unworkable and also runs somewhat counter to the views expressed by Directors in the Summing Up of the discussion on the establishment of the CCFF (Buff/88/133, 7/15/88, page 1) where it was stated that "Directors also concluded that in order to avoid creating an unduly rigid and complex system, many detailed operational aspects of contingency financing would have to be developed with the authorities at the time each associated arrangement is framed, on an experimental and case-by-case basis."

On the other hand, ICMs have been incorporated into Fund arrangements with few ex ante restrictions (but with general principles in mind), and the results generally have been welcomed by the Board. In the Summing Up of the 1991 conditionality review (Buff/91/144, 8/13/91), Directors agreed that "for the present, contingency provisions should continue to be formulated on an individual country basis, but with close attention to the general policies of the Fund, and the need to avoid undue complications of program formulation and monitoring procedures." The staff's proposal would seek to bring together these approaches into a workable contingency element of the CCFF.

The staff would propose that the contingency mechanisms under the CCFF be simplified further to remove the remaining impediments which related principally to fixed baselines and fixed covered variables; declining financing proportions; and the nonautomaticity of adjustments to performance criteria. The staff would therefore recommend that the specifications of modalities in the CCFF Decision be deleted and that the operational guidelines be rewritten to permit a greater range of possible specifications along the lines used in practice under ICMs. Contingency mechanisms would be prespecified in individual Fund arrangements based on broad policy guidance from the Board rather than the detailed prespecification of modalities as at present in the decision. The staff proposal would also not preclude the continued use of ICMs without contingent Fund financing, as understandings on the program adaptations might be crucially important even where contingent financing was not considered desirable or necessary. ICMs could continue to be used for contingencies related to capital account variables, but Fund financing under the CCFF would not be considered for such contingencies as it would be inconsistent with the purposes of the CCFF. 1/

While the staff proposal would imply a substantial simplification in the CCFF Decision, the basic purpose and philosophy underlying the facility would be retained--to provide an ex ante assurance by the Fund of the availability of contingent resources in circumstances where the member can specify ex ante a contingency mechanism. Some key provisions of the contingent element in the CCFF Decision would not be altered. In particular, the proposal would not change the provisions related to access, coverage of key exogenous current account variables, or to predefined financing proportions (although financing proportions would no longer be expected to decline), and would retain the principle of symmetry; and in cases where the possibility of Fund financing was triggered by an adverse deviation, there would be a Board review to consider whether the program continued to be adequately financed. In the event, additional Fund financing would continue to be limited by the deviation in the member's actual balance of payments from its targeted level. Where favorable deviations prevailed, higher reserve accumulation would automatically be targeted (as the first preferred option), but the Fund would continue to have the second option of reducing the amount of the Fund arrangement. 2/

In its present form, an ECM is activated on the basis of a review by the Executive Board, at which time a decision could be taken to adjust the member's performance criteria (paragraph 25 of the CCFF Decision). Under the staff proposal, this provision of the CCFF decision would no longer be necessary, as automatic adjustments to performance criteria under the Fund arrangement approved by the Board would be prespecified (for whatever period the performance criteria themselves would be set). These adjustments would need to be featured prominently and fully documented in the staff reports supporting requests for such Fund arrangements and in subsequent program reviews. If the contingency mechanism were triggered by an adverse development, the member would be able to use additional international

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1/ As under the existing CCFF Decision, deviations in net capital flows would not be covered by contingency mechanisms in view of the difficulties in assessing whether or not such flows were beyond the control of the member and because the CCFF has been created to cope with current account variables only.

2/ These symmetry adjustments would not be required to be equivalent to the additional Fund financing that could have been made available in the event of an equivalent unfavorable deviation and would not necessarily be subject to a maximum limit.

reserves under the Fund arrangement. The member could then request disbursement of contingent Fund financing under the CCFF to "top up" international reserves it had already drawn down under the Fund arrangement in accordance with the in-built contingency mechanism. This request could be submitted to the Executive Board according to the existing CCFF procedures normally in the context of a regular program review or, if the situation warranted, in an ad hoc request.

In light of the difficulties with fixed baselines, paragraph 19(c) of the CCFF Decision would be revised to require that the contingency baseline would at all times coincide with the baseline of the associated arrangement, covering the time period for which performance criteria have been set. Other elements of the contingency mechanism (threshold, financing proportion, maximum adjustment of performance criteria) could also be subject to modification in the context of revisions to the associated program. Access under the contingency element would, however, be maintained at its originally approved amount, unless the access under the arrangement was changed. Access limits would be retained unchanged both in respect of the facility (65 percent of quota, including the optional tranche) and the associated arrangement (70 percent of the amount available under the arrangement for the corresponding period). The sublimit on access on account of interest rate deviations (35 percent of quota) would also be retained.

Financing proportions would need to be specified in the contingency mechanism in order for performance criteria to adjust automatically to deviations from the baseline path of covered variables. Although conceptually declining financing proportions are preferable, operational simplicity would argue for a constant financing proportion. The staff would suggest that future guidance take a neutral view, leaving the matter to be dictated by the circumstances of the member. Contingency mechanisms could incorporate thresholds if appropriate, but the present specification of a norm of 10 percent of quota would be eliminated. The staff would recommend that there be no prescription regarding thresholds; instead, they would be determined on a case-by-case basis depending, for example, on the historical volatility of the covered variable and the specification of financing proportions. The requirement of a maximum adjustment to performance criterion on international reserves in the event of a favorable shock (paragraph 19(a)(v)) would also be eliminated; appropriate caps would be determined based on the member's circumstances, including its international reserve position and expected progress in achieving external viability.

The flexibility for program design and implementation provided by these proposed changes needs to be weighed against their implications for the program's viability in the face of unexpected developments. Problems could potentially arise in some circumstances if adjustment clauses were to provide for a substantial reduction in the targeted accumulation of international reserves in the event of an unfavorable shock. In that event, three primary principles would guide the staff in the design of a contingency mechanism: (i) that the unexpected drawdown in international reserves and the implications for the external accounts do not jeopardize the basic program objectives (especially the achievement of adequate progress toward external viability); (ii) that adjustment policies in response to the external shock be credible and adequate to the new circumstances; and (iii) that the program should remain fully financed.

Parallel contingency financing would continue to be pursued vigorously, but Fund contingency mechanisms would generally be approved even if such financing were not in place. Disbursements of contingent Fund resources would, however, continue to be based on an Executive Board assessment that the program remains viable.

A contingency mechanism that is limited to a few key exogenous current account variables leaves open the possibility that developments in covered variables may be offset by opposite developments in uncovered variables. To address this possibility, two safeguards were introduced in 1990 when permissible coverage was narrowed. First, the staff was expected to evaluate the actual current account position to ascertain the extent to which there had been any offsetting movements in the current account owing to exogenous factors. In making this assessment, the benefit of the doubt would be in favor of the member. This approach has proven in practice to be very difficult to implement because a quarterly pattern for the current account has not always been specified in the relevant staff report and prompt monitoring relies to a high degree on estimated data based on limited actual returns, which would not seem to give the staff a solid enough basis to reduce contingent financing. The staff would suggest therefore that this requirement be dropped.

Contingency financing could, however, continue to be limited by the second safeguard--namely, the amount by which the actual overall balance of payments outturn fell short of the amount targeted in the program. This safeguard does not suffer from either of the operational shortcomings noted for the current account variables because performance criteria on net international reserves are typically specified quarterly and monitored on the basis of actual data. Thus, it would seem advisable to limit Fund financing to the extent that the member's overall balance of payments outturn exceeded the overall balance of payments deficit either as specified in the member's program when approved by the Board or as modified by a subsequent Board review.

Experience with both types of contingency mechanisms suggests that it is not possible to design a mechanism that provides protection against all possible external shocks. The staff thus would expect to focus in the future on cases where a small number of key exogenous external current account variables can be identified that could threaten program implementation. Deviations in current account variables which could not be foreseen easily, such as a drought, could also threaten a program's viability. Such deviations would continue to be handled by waivers and modifications of performance criteria and, where appropriate, rephasing and augmentation of arrangements, and access to compensatory financing. In the extreme, an existing Fund arrangement may need to be canceled and replaced by a new arrangement with appropriate policies and access designed to address the new circumstances. For these reasons, it is difficult to predict the extent to which contingency mechanisms supported by CCFF resources would be utilized if the staff's proposal were accepted.

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The staff has proposed a substantial simplification of the existing provisions of the contingency element of the CCFF. The objective would remain to provide members with firm assurances of the circumstances under which contingent financing would become available in situations where a contingency mechanism--now using adjustable performance criteria--could be precisely specified in advance. At the same time, ex ante specification of operating modalities would be removed from the CCFF Decision, which would make it easier to tailor such mechanisms to individual country circumstances.

The previously circulated operational guidelines of the CCFF would be amended in light of Directors' remarks and of experience with ECMs and ICMs. Such guidelines would avoid rigid specification of modalities; rather, they would set down the general principles governing the various modalities and detailed specifications would be undertaken on a case-by-case basis. Specifications within the general principles would be described in detail in the context of each proposed Fund arrangement and presented in the documentation supporting a request for a Fund arrangement. As each new case is commented on by Directors, lessons will be garnered to be applied appropriately in subsequent cases. The staff would recommend that in three years' time, a general review of the CCFF take place to examine, inter alia, operations under the proposed simplified contingency element. If unforeseen issues arise, an earlier review could be conducted.

III. Operation of the Compensatory Financing Element

Financing under the compensatory element of the CCFF covers, within limits, temporary shortfalls in export receipts and excesses in the cost of cereal imports. 1/ For a member to qualify for such assistance it must face a balance of payments need resulting from a temporary shortfall/excess attributable to circumstances largely beyond its control. Compensatory

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1/ The temporary oil element was available for excess periods ending not later than December 31, 1991. Requests for compensation had to be initiated not later than December 31, 1991; purchases (or initial purchases in cases of phasing) related to such requests had to be made prior to June 30, 1992.

financing requires that the member satisfy a test of cooperation with the Fund with respect to finding appropriate solutions to its balance of payments difficulties. A shortfall (excess) is calculated as the amount by which a country's export earnings (cereal import costs or when applicable oil import costs) in the shortfall (excess) year are below (above) its medium-term trend. 1/ 2/ An excess in cereal import costs may be compensated only to the extent that it is not offset by an excess in export earnings. The same rule applied to excesses in oil import costs under the now expired oil element of the CCFF.

Drawings under the CCFF are additional to those under the credit tranche policies and are subject to access limits and cooperation requirements specified in the CCFF Decision. 3/ Access is based on the calculated compensable amount subject to limits of 40 percent of quota for export shortfalls and of 17 percent of quota for cereals import excess. An optional tranche equivalent to 25 percent of quota can be added to either the export, cereal, or contingency elements, provided the member meets a higher test of cooperation. 4/

1. Experience since the 1990 review

During January 1990-November 1992, 17 members made 25 compensatory purchases totalling SDR 3.5 billion. (Net of prompt repurchases by four members resulting from overcompensation, compensatory purchases were SDR 3.2 billion.) This relatively high level of overall usage masks considerable annual variations: in 1990, only two compensatory financing purchases were made for a total of SDR 68 million--the lowest annual total since 1970--while in 1991 compensatory purchases reached SDR 2.9 billion--

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1/ For expositional ease, most references in this paper will be to shortfalls and shortfall years, but these references could apply equally to cereal (or oil) import excesses or a combination of shortfalls and excesses.

2/ The medium-term trend is defined as the five-year average centered on the shortfall/excess year. In computing this trend, a geometric average is used for export earnings and an arithmetic average is used for cereal import costs (or when applicable oil import costs). The rationales for the different averaging techniques are provided in the background paper. Export projections for the two post-shortfall years may not exceed the level of actual export earnings in the pre-shortfall period by more than 20 percent.

3/ If apart from the effects of the shortfall/excess, a member's balance of payments is satisfactory, access limits under the export and cereal elements and joint access limits are 83 percent of quota, 83 percent of quota, and 105 percent of quota, respectively.

4/ For example, in the case of an export shortfall where the member's record of past cooperation with the Fund had been satisfactory, the higher cooperation test would be satisfied by a Fund arrangement with upper credit tranche conditionality (either existing or concurrently approved) or by current and prospective policies that would in the Fund's view meet the criteria for such an arrangement.

the highest since the establishment of the old compensatory financing facility in 1963. The high level of purchases in 1991 reflected the introduction of the temporary provisions for compensating excesses in the cost of oil imports. Thus, 19 of the 25 purchases related to excesses in oil import costs, representing over two-thirds of total compensatory purchases during the period under review (Table 5).

No purchases under the cereal element of the CCFF have been made since June 1989. Some countries in southern Africa or Eastern Europe that are suffering from damage to food crops and higher food import requirements as a result of severe droughts could request compensatory financing under the cereal element of the facility; however to date, these countries--particularly those in southern Africa--have sought financing from other sources, mainly on concessional terms.

Compensatory purchases during 1990-92 covered 65 percent of calculated shortfalls/excesses and amounted to 34 percent of quota, on average, 1/ compared with a compensation ratio of 50 percent and average access of 43 percent of quota during the 1980s. For 15 of the 25 requests made in 1990-92 (multiple drawings under the phased drawing procedure of the oil element are counted as a single purchase), compensatory purchases were equal to the entire calculated shortfall and averaged about 30 percent of quota; in the remaining 10 cases, purchases were constrained by access or cooperation limits and purchases averaged about 44 percent of quota.

Following the decision in 1990 to permit the use of up to 12 months of estimated data in calculating export shortfalls (compared to 6 months under the earlier decision), the early drawing procedures were more heavily utilized than before. In 1991-92, 70 percent of compensatory purchases were based on the early drawing procedures, compared with 40 percent in 1980-1990. The greater use of estimated data and the introduction of phasing in connection with the temporary oil element also increased the incidence of multiple purchases by members. Five members made multiple purchases during the period under review. India and Czechoslovakia each made three purchases with respect to the same shortfall year--the first triple drawings for a given shortfall year. Hungary, Jamaica, and Romania each made two purchases with respect to the same shortfall year, while Romania also made a third purchase with respect to a shortfall year that overlapped by nine months the shortfall year for the previous two purchases.

1/ Calculations are based on a weighted average using final calculations where available,taking into account early repurchases, and exclude export shortfalls for countries in Eastern Europe for which compensatory financing was not made available. Including the export shortfalls of East European countries would reduce the compensation ratio to 35 percent.

Final calculations have been completed for all 13 countries that made purchases under the early drawing procedure in 1990-92. 1/ These calculations indicate that since 1990 the aggregate amount of undercompensation in purchases under the early drawing procedure has exceeded the aggregate amount of overcompensation in purchases by about SDR 130 million. 2/ Overcompensation occurred with respect to purchases by only four countries (Bulgaria, Romania, Hungary, and Czechoslovakia) for a total amount of SDR 339 million; in these cases, prompt repurchases were, on average, 50 percent of the initial purchases, compared with an average of 40 percent during the 1980's. In three of the four cases, prompt repurchases were completed within the prescribed 30-day period, while in the fourth case it was completed a few months thereafter. In three cases of overcompensation, new compensatory requests were made either in respect of the same shortfall year on the basis of new data and new projections, or for a new but partially overlapping shortfall year.

2. Operational issues

During the period since the last review of the CCFF, the compensatory financing element of the CCFF has undergone significant modifications and a number of operational questions have arisen. These have related to: (a) timing of compensatory requests--the six-month "rule"--and the early drawing procedures, including the associated implications of a greater use of estimated data, the basis for final calculations and experience with prompt repurchase expectations; (b) netting the import content of exports; (c) capacity to repay provisions; (d) cooperation requirements, particularly near the end of Fund arrangements; (e) determination of compensable amounts; and (f) the evaluation of temporariness and systemic changes in former CMEA members. These issues are discussed below.

a. Timing of requests and early drawing procedures

The CCFF was designed to provide Fund financing quickly, in response to temporary and exogenous shocks. To this end, requests for compensatory financing have generally been discussed by the Executive Board no later than

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1/ The four country cases for which there was overcompensation were more than offset by two country cases for which there was undercompensation. In the remaining country cases during this period, the amount of the purchase--both with respect to the initial and final calculations---was constrained by access or cooperation limits.

2/ The average time lag in issuance of reports on the final calculation has decreased gradually from 12 months in the period 1976-79 to 10 months in 1980-89 and to 8 months in 1990-92. There appears to be no consistent pattern underlying lags. For example, the average reporting lag for countries that were overcompensated has been shorter and has declined faster than for other countries. Nor does a positive relationship appear to exist between the reporting lag and the number of months of estimated data used in the shortfall calculation.

six months after the end of a shortfall year; since 1975, the early drawing procedures have permitted the use of estimated data to facilitate timely purchases. The procedures to ensure quick disbursement under the CCFF have, in general, functioned as intended. Nevertheless, a review of these procedures seems appropriate in light of questions raised by Directors and the experience with recent modifications to the facility.

(1) Six-month "rule" on the timing of requests

Although such a provision is not specified in the CCFF Decision, long established practice has been to limit the length of time between the end of a shortfall year and the associated compensatory purchase to a period of no more than six months. Without such a limitation, compensatory requests could conceivably pertain to export shortfalls several years in the past. This would be inconsistent with a basic rationale for the facility and could result in Fund financing being provided to meet a balance of payments need directly related to the export shortfall. Limited use of the compensatory financing facility in the years prior to 1975 was partly attributed to the difficulty many countries faced in providing trade data within six months of the end of the shortfall year; strict application of the six-month rule meant that these countries could not make compensatory financing drawings. In considering this question at the 1975 review, the Board chose to introduce the early drawing procedures rather than to relax the six-month rule.

Notwithstanding the close adherence to the six-month rule, there are questions as to the basis for granting exceptions, giving rise in turn to concerns related to uniformity of treatment. 1/ Moreover, the Board has not always been informed explicitly when a compensatory request fails to meet the six-month rule. (Though this is, of course, evident from the timing of the request and shortfall year.) For good order and to ensure that emphasis continues to be placed on prompt requests, the staff would suggest that Directors reaffirm the principle that compensatory requests should be timely--namely that the Executive Board should consider the request for a compensatory drawing within six months of the end of the

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1/ The six-month "rule" has been observed in over 85 percent of the compensatory purchases (273 of 328 cases) since the facility was established in 1963; during 1990-92, the six-month rule was observed in 23 of 25 cases. In 35 of the 55 cases where the six-month rule was not observed, the staff paper analyzing the compensatory financing request was circulated to the Board within six months of the end of the shortfall year. In only 5 percent of the cases since 1963--17 purchases--was the six-month limit exceeded by more than one month. In almost all cases where the six month rule was exceeded by more than one month, the delay was occasioned by a delay in approving a concurrent arrangement to use Fund resources in the upper credit tranches. In the exceptional case--Jordan in 1989--the purchase augmented a compensatory financing purchase made one month earlier and the delay related to questions concerning the interpretation of the cooperation requirement.

shortfall year, subject to the possibility of technical (e.g., unrelated to a delay in a Fund arrangement) delays, not exceeding 30 days; over 90 percent of past cases would have met this standard and with the more liberal use of estimated data, the six-month rule should be less difficult to adhere to than in the past. The Executive Board would be informed in cases of delay and could take into account the reasons given for the delay in deciding whether to approve a member's request. In other cases, the shortfall period would be shifted to accommodate the deadline.

(2) Use of estimated data

The extension in November 1990 from six to twelve months in the period for which estimated data on earnings from merchandise exports can be used in the shortfall calculations brought the early drawing provisions with respect to export earnings into line with those in use since 1979 for services receipts from tourism and workers' remittances and since 1981 for cereal import costs. Use of twelve months of estimated data was also permitted under the temporary oil import element introduced at the same time. However, given the then-highly-uncertain prospects for oil prices and to reduce the possibility of an expectation of prompt repurchase owing to overcompensation, the oil element also included a requirement that drawings be phased whenever more than nine months of estimated data were utilized in the calculation of an oil import excess (for details see text box on page 23). It was indicated at that time that the question of the increased use of estimated data could be reconsidered at the time of the next CCFF review.

Since 1990, there have been eight cases involving the use of more than six months of estimated data; five purchases (Bulgaria, Czechoslovakia, Hungary, Jamaica, and Poland) were made as first drawings under the phased drawing procedure of the oil element. Czechoslovakia and Jamaica made second drawings; for Bulgaria and Hungary, when additional actual data became available, the recalculated excess did not support a further drawing; and in the case of Poland, no second drawing was made because the country's macroeconomic policies had materially changed as the Fund-supported program was off track. The phased drawing procedure succeeded in decreasing the incidence and magnitude of early repurchases: without this procedure, repurchase expectations for Bulgaria, Czechoslovakia, and Hungary would have been substantially larger and for Poland a prompt repurchase expectation would have become necessary. Overall, it is estimated that in the absence of this phasing procedure, overcompensation would have been more than SDR 300 million higher than it actually was.

As the staff observed when it was proposed to lengthen to twelve months the period for which estimated data could be used, any such lengthening tends to make more uncertain the estimates for the shortfall period and the projections for the post-shortfall period and thereby increases the risk of overcompensation. On the basis of recent limited experience, it would seem

Calculation of Compensable Amounts

I. If actual data were used for the entire compensable year:	II. If estimated data were used for any portion of the compensable year:	III. Under the oil element, if estimated data were used for 9 months or more of the compensable year:
1. Purchases would be based on calculated shortfall and applicable cooperation requirements/access limits. This would be the final calculation and no early repurchase expectation could arise. The member could subsequently request additional compensatory financing for a wholly new or a partly overlapping shortfall year. New projections for the post-shortfall years would be needed in either case, and a deduction would be made, if necessary, to avoid double compensation related to overlapping shortfall periods. The new request would also need to meet the applicable cooperation requirements and access limits.	1. Purchase would be based on calculated shortfall using estimated data and applicable cooperation requirements/access limits, as above.	1. The purchase would be phased with an amount equivalent to 65 percent of the initially calculated compensable amount made available on approval of the request. Given the acute uncertainty regarding future oil prices at the time the oil element was introduced in November 1990, it was considered appropriate to have updated calculations at the time of a second purchase to lessen the possibility of under- or overcompensation; effectively, a second purchase under the phasing procedure was calculated like a second purchase for the same shortfall year under the early drawing procedure (II.3).
Not applicable	2. Once actual data become available for the entire shortfall year, a final calculation of the compensable amount is made. For this calculation, the initial projections for post-shortfall years are retained.	2. Once six months of actual data became available, the compensable amount would be recalculated using an updated estimate for the shortfall year and updated projections for the post-shortfall years. If the then calculated compensable amount were larger than the initial purchase, a second purchase could be made for up to the recalculated amount (less the initial purchase), subject to cooperation and access limits. If the then calculated compensable amount was smaller than the initial purchase, the Board agreed that the question of overcompensation would be raised only when actual data for the full shortfall year became available.
Not Applicable	3. If the final calculation determines that the member has been overcompensated, the member is notified and there is an expectation of a prompt repurchase of the overcompensated amount. Should these calculations indicate undercompensation, then new calculations are made but on the basis of updated post-shortfall year projections. If these new calculations produce a compensable amount, then the member may request a compensatory purchase so long as the other conditions for the drawing are met, including cooperation requirements/access limits and the six-month rule.	3. Once actual data became available for the entire compensable year, then the procedures in II.2 and II.3 would be followed but using the projections for the post-compensable years that underlaid the calculation for the most recent purchase. This is the same practice that applies under the early drawing procedure for multiple purchases for the same compensable year.

that the greater use of estimated data has indeed increased the incidence and magnitude of overcompensation and of prompt repurchase expectations. Phasing was introduced as part of the oil element to cope with the potential volatility of oil prices, but the behavior of non-oil primary commodity prices (a major factor determining export shortfalls of member countries) also has experienced substantial volatility. Consequently, price estimates for the shortfall period--particularly now that it has been extended to 12 months--are subject to sometimes quite large forecasting errors.

To address these problems, consideration might be given to restricting the use of estimated data in the compensable year to six months, as was the case for export data prior to the modification in 1990. This approach would, however, inhibit the timely availability of Fund financing. Alternatively, it may be more appropriate to introduce a phasing procedure for export shortfalls and/or cereals excesses. Phasing provisions could apply when estimated data were used for six months or more (the length of time for which estimated data formerly was permitted), or nine months or more (the same time period set under the oil element). Clearly a shorter period for which estimated data may be used before triggering a phasing procedure would tend to lessen the risk of overcompensation. However, it has not been possible to quantify a six-month counterfactual based on experience for the period under review. The staff would therefore recommend that, at least for an initial period, a phasing procedure apply under the compensatory element when nine months or more of estimated data are used, as was the case under the oil element.

The amount of compensatory financing made available in the first purchase under the proposed phasing procedure could be 65 percent of the initially calculated access--as under the oil element. A second purchase could be requested once sufficient actual data were available (i.e., six months), subject to a revised calculation of the compensable amount that incorporated updated price and volume projections for the remainder of the compensable year and for the post-compensable years and to other applicable conditions under the facility. 1/ Under the oil element, conditionality was associated with the second purchase, but was defined somewhat differently under that element even for initial purchases; owing to these differences, the staff would, therefore for simplicity, propose to use the existing cooperation tests. 2/ In particular, in order that the second purchase could be made, the Fund would need to be satisfied that the relevant cooperation provisions of the CCFF Decision (e.g., paragraphs

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1/ Performing the calculations in this fashion would lessen the possibility of under- or overcompensation.

2/ If the second purchase requested, when added to the first purchase already made, did not exceed the access limit under which the first purchase was made, the second purchase would be subject to the same cooperation requirement. If the second purchase, when added to the first purchase, did exceed the access limit under which the first purchase was made, the usual cooperation requirements would apply.

12(a)(i) and 12(a)(ii)) continued to be met. In any event, it would remain possible for the member to request a new compensatory purchase for the same or overlapping shortfall period even before actual data were available, provided that all relevant conditions were met, including the six-month rule. A phasing procedure would tend to lessen the risk that an expectation of early repurchase would arise in the event of overcompen-sation. The staff would monitor closely the experience with this phasing procedure, particularly with regard to evaluating the implications of using different time periods for estimated data.

(3) Final calculations

For the final calculation of the compensable amount, estimated data for the compensable year are replaced with actual data but the original projections are retained for the two post-shortfall years. 1/ At the same time, a member may, however, make a further compensatory financing request in respect of the same shortfall year based on new projections for the post-shortfall years (if the calculations justify it and other conditions of the CCFF are satisfied). In some cases, revised projections for the post-compensable years may permit a member to request a new purchase for the same compensable year at the same time as it is expected to make a prompt repurchase on the basis of the earlier projections. Such a new request would be considered on its own merits and would require a separate Board decision. In fact, this has happened on several occasions recently, and the alternate shrinking and increasing of the calculated compensable amount for the same period has given the CCFF an "Alice-in-Wonderland" quality as noted in an earlier Board discussion. 2/

The instances of this "Alice-in-Wonderland" effect could well be increased in cases of multiple purchases using estimated data for the same shortfall year, because the present CCFF Decision would require a separate final calculation be performed for each estimated purchase. Such multiple final calculations would use the same actual final data for the shortfall year but the post-shortfall year projections would differ for each calculation so that each projection would be consistent with those associated with the original purchase. It could be the case that separate multiple final calculations could lead to different conclusions as regards overcompensation and action would need to be taken if any of the final calculations indicated overcompensation. To avoid perhaps unnecessary repurchase expectations (and new compensatory requests), the staff would

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1/ If data for pre-shortfall years have been revised, the revised data would be used in the final calculation. If multiple purchases were made under the early drawing procedure or purchases were phased as under the oil element, the post-shortfall year projections underlying the latest purchase are retained.

2/ See the minutes for the Board meeting on the request by the Czech and Slovak Federal Republics for a purchase under the oil element (EBM/92/3, 1/10/92).

recommend that in the case of multiple purchases for the same shortfall year, only one final calculation be performed based on the post-shortfall year projections used for the latest purchase. If the shortfall years were not identical, then separate final calculations would continue to be needed.

A recent staff paper explained the rationale for the existing procedure for final calculations (EBS/92/23, 2/11/92, page 3). The procedure reduces the uncertainties for members utilizing the early drawing procedure, as the compensable amount is affected only by a difference between the actual and estimated data in the shortfall year and not by changes in projections for the post-shortfall years, which would themselves be subject to uncertainty and, possibly, dispute. If the projections for post-shortfall years were also subject to change for the final calculations, there would be an added element of uncertainty for the member as to the final compensable amount and it could be subject to a prompt repurchase expectation solely because of revised projections for the post-shortfall years.

The use of revised projections for final calculations could eliminate the "Alice-in-Wonderland" effect noted above. It would also make the final calculation under the early drawing procedure equivalent to the calculation that would have been obtained had the member waited for actual data to become available before making the compensatory request. New discussions with the member would, however, be needed to arrive at judgmental forecasts for the post-shortfall years and these discussions could delay the present automatic process of arriving at a final calculation for the compensable amount in all cases, not just those where there may be a newly calculated shortfall. Moreover, as the present approach is a somewhat mechanical exercise, papers reporting on final calculations have been circulated only for information of Executive Directors. If revised judgmental projections were to be used in final calculations, the final calculations of the compensable amount would have to be submitted for approval by the Board. Thus, although revised projections for the post-shortfall years would put an end to the Alice-in-Wonderland effect, it would also complicate an otherwise straightforward calculation by the staff. In view of these complications, the staff would recommend on balance that the present procedures be retained.

(4) Prompt repurchase expectations

There have been 105 compensatory purchases under the early drawing procedures since their introduction in December 1975 (one third of all compensatory purchases in this period). Twenty-two, or one fifth, of these purchases gave rise to expectations of prompt repurchases for part or all of the initial purchases. Since 1990, the use of the early drawing procedures has increased, and a greater proportion of the purchases made under these procedures has given rise to an expectation of prompt repurchase; in this period, 16 of 23 purchases (70 percent) were made under the early drawing procedures and prompt repurchase expectations arose in almost one third of these cases (five of 16 cases).

Following a discussion in 1982 of prompt repurchase expectations that may arise as a result of overcompensation, the Executive Board decided that "prompt repurchase ... would mean that the repurchase would normally be made within a period of 30 days" and procedures were specified to deal with situations where the normal period of prompt repurchase was not respected (EBM/82/1, 1/6/82, pages 20-21). In ten of the 21 cases in which there was an expectation of a prompt repurchase in the period since 1975, there was a delay of more than 30 days between the notification to the Executive Board and the repurchase; the longest delay was nine months. Three of the four countries subject to a prompt repurchase expectation during 1990-92 fulfilled their expectation within 30 days; and the fourth country met its repurchase expectation within three months.

In accordance with the decisions taken by the Executive Board at EBM/82/1, in the event of a delay of more than 30 days in fulfilling the repurchase expectation, the Managing Director has since 1982 reported the matter to the Executive Board within a two-week period, with an explanation of the delay and a proposal on how to deal with the question in the most prompt and appropriate manner, including any action the Executive Board might take. In two of the eight cases in which a delay has emerged since that time, members discharged their repurchase expectation within two weeks of the 30-day period, eliminating the need to submit such a report to the Executive Board.

The reports issued in the six other cases have indicated different approaches to resolution of the situation. In three cases, the member was permitted to purchase under a new Fund arrangement prior to discharging the repurchase expectation. In two cases, members made a purchase under a Fund arrangement within two weeks of discharging the repurchase expectation. In the case where no Fund-arrangement was being considered, the repurchase was twice deferred. In the end, the member met the repurchase expectation in the end with a total lag of almost 4 months beyond the 30-day period.

Directors have requested the staff to review possible ways to strengthen the responses available to the Fund in case a member fails to meet a repurchase expectation within 30 days. Three options have been discussed in the past by the Executive Board in the context of a previous review of repurchase expectations under the CCFF, as well as in discussions on repurchase expectations with respect to noncomplying purchases and the use of Fund resources for debt and debt service reduction operations. 1/

1/ See "Representation of Intention as to Repurchase" (SM/81/234, 12/2/81, and EBM/82/1); "Misreporting and Noncomplying Purchases Under Fund Arrangements - Guidelines on Remedial Action" (EBS/84/196, 9/13/84, EBM/84/152 and EBM/84/153); and "Debt and Debt Service Reduction Operations-Early Repurchase Expectations" (EBS/89/224, 11/22/89, EBM/89/165 and EBM/89/166).

One option could be to establish an early repurchase obligation, as opposed to an expectation, by accelerating the due date on the overcompensated amount. Such a policy would require a Board decision taken by an 85 percent majority of the total voting power and would apply uniformly to all members; failure to meet such an obligation would result in arrears to the Fund. In 1982 the Board discussed this possibility but decided not to establish such a repurchase obligation, given the generally satisfactory experience with the existing procedures at that time and the fact that creating such an obligation could result in unwanted rigidity. In the context of the decisions on noncomplying purchases and on debt and debt service reduction operations, Directors again stressed the need for flexibility in the relevant circumstances--involving an acceleration of payments to the Fund--as an argument for adopting an early repurchase expectation rather than an obligation.

Under a second option, nonfulfillment of a repurchase expectation could result in the initiation of a procedure that may lead to a declaration of ineligibility to use the general resources of the Fund (under Article V, Section 5). The Executive Board could decide (by a majority vote of the votes cast) that an individual member that failed to meet the prompt repurchase expectation "is using the general resources of the Fund in a manner contrary to the purposes of the Fund". The applicability of Article V, Section 5, to a member that has not met an expectation of repurchase would depend on the actual use made by the member of the Fund resources that it is expected to repurchase. As was indicated in connection with Fund support for debt and debt service reduction operations, a definitive conclusion could not be based on the mere fact that the member did not use the resources for the specified purpose, but more broadly on the judgment that actual use of the Fund's resources by the member was inconsistent with the purposes of the Fund. In the case of the repurchase expectation with respect to debt and debt service reduction operations, the Executive Board decided not to include an explicit reference to this procedure in the decision, because the absence of such reference would not in any event prevent the Executive Board from initiating the procedure in a particular case if it considered that appropriate.

A third option, which also could be adopted by a majority of the votes cast, would be to include in relevant decisions a provision that if a member fails to meet a CCFF repurchase expectation (within 30 days), until the expectation had been fulfilled, the member's right to make further purchases under an existing Fund arrangement would be automatically suspended and the Managing Director would not recommend approval by the Executive Board of any request for the use of Fund's general resources by that member. Such provisions have been introduced into the decisions on noncomplying purchases and debt and debt service reduction operations, and their application in the CCFF context would appear a reasonable parallel to safeguard the Fund's resources in the circumstances in question. The staff would recommend adoption of this option.

b. Netting the import content of exports

Issues relating to netting the import content of exports for the purposes of calculating compensable shortfalls arose during 1992 in the context of a request for a compensatory purchase by Israel. 1/ Earlier requests by Israel (1976) and Panama (1976, 1983) had prompted Board reviews of the appropriateness of netting the import content of exports for purposes of compensatory calculations. 2/ As part of the 1983 CCF review, the staff explored possible rules by which export shortfalls could be adjusted to take into account the import content of exports, particularly for refined petroleum, polished diamonds and in-bond industries. Two alternative methods were presented: (i) netting out the value of imports of the principal raw material inputs, and (ii) calculating value-added. Although the economic rationale underlying the concept of netting was accepted by Executive Directors, its practical difficulties were considered prohibitive. Therefore, the Board decided to maintain the use of gross exports (excluding re-exports) in export calculations. This position was reaffirmed at the 1987 review of the CCF.

In the staff's view, recent experience has provided evidence that, at least in the cases of diamonds, refined petroleum products, and some cases of in-bond exports, these practical difficulties can now be resolved. 3/ Israel requested a compensatory purchase in 1992 for an export shortfall that included a decline in cut diamond exports, that also led directly to lower imports of raw diamonds. The staff reported the calculated export shortfall on a gross and net basis and the compensable amount was based on the gross calculation. 4/ The import content of the relevant export items (i.e., refined petroleum products, polished diamonds, and in-bond) were on average over the relevant five-year periods from 80 percent, 90 percent, and 50 percent, respectively.

In the case of requests by eastern European countries (e.g., Bulgaria, Czechoslovakia, Hungary, Poland, and Romania) under the oil element, exports of crude and refined petroleum were netted from oil imports to derive an

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1/ "Israel - Use of Fund Resources - Request for Purchase Under the Compensatory and Contingency Financing Facility" (EBS/92/41, 3/9/92).

2/ "Compensatory Financing Review" (SM/77/38, 2/16/77); and "Compensatory Financing Facility - Treatment of Import Content of Exports" (SM/83/262, 12/27/83).

3/ In the cases of Haiti (1981) and Mexico (1989), exports by in-bond industries were recorded in value added terms, implicitly netting the import content of those exports.

4/ The actual purchase was constrained at 40 percent of quota and even calculated on a net basis, the export shortfall would have justified the full purchase.

estimate of oil imports destined for domestic consumption. 1/ The crude oil equivalent of exported refined products was netted from imports of crude oil, and the adjusted crude oil import volume was valued at the crude oil import price. Refined product imports (valued to the extent possible at world market prices) were added to this figure to estimate the oil import cost employed in the excess calculation. The import timing problem was resolved by reference to changes in inventories and adopting a shortfall calculation based on the "normal" level of inventories. 2/

Allocating the import content to an end product has not proven to be a problem in these recent cases, because netting was attempted only where there were large, direct and easily measured import components of individual export items. In the eastern European cases it proved possible to distinguish oil destined for domestic use from that which was refined and exported. In the case of Israel it was clear that virtually all of the imported raw diamonds were for export. The same conditions are likely to hold for in-bond industries. In general, the difficulty of quantifying import content appears to be less, the larger and more important such content is.

On balance, recent experience suggests that the practical problems that previously hindered the application of a netting procedure have been solved in certain instances. It is therefore proposed that calculations of the compensable amount for an export shortfall should be presented on a net basis where the import content of an export item is large (i.e., above 50 percent) and direct (e.g., imported inputs without material intermediate domestic processing) and where adequate data are available (e.g., refined petroleum products, cut diamonds and in bond industries). The staff would provide a full analysis and justification for netting in any individual case

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1/ The practice of netting under the oil element was described in the "Report of Operations Under the Oil Element of the CCFF" (EBS/91/49, 3/19/91) and "Recent Experience in Eastern Europe with the Oil Element of the CCFF" (EBS/92/23, 2/11/92). This was done because, under the CCFF Decision, compensation of excesses in oil import costs (like compensation of excesses in cereal import costs) cannot be made in isolation of the export performance. Specifically, such an excess may be compensated only to the extent that it is not offset by an export excess. In principle, therefore, all exports earnings should be taken into account. In the case of these eastern European countries, it was not possible to measure exports other than oil exports in any reliable fashion for this purpose and therefore only oil exports could be offset against oil imports.

2/ Stock adjustment procedures had been discussed by the Board in 1976, as reported in "CFF--Adjustment for Stock Accumulation" (SM/76/189, 8/26/76). These procedures are also summarized in "CFF - The Meaning of "Shortfall Attributable to Circumstances Beyond the Control of the Member", Annex I (EBS/82/42, 3/12/82). In these cases, variations in the timing of imports of the raw material were identified as movement in the stock of inventories.

where it is used. In practice, the staff expects that the netting procedure would be applied sparingly and its use would be kept under review.

c. Capacity to repay provision

As a result of the experience with countries in protracted arrears to the Fund, heightened attention has been focused on a member's prospects for achieving external viability and capacity to repay the Fund. In the context of establishment of the CCFF in 1988, this question was discussed and paragraph 9 of the CCFF Decision was inserted to state that the Fund "in providing financing pursuant to [the CCFF] Decision, as with other policies of the Fund, shall pay due attention to the member's capacity to service its financial obligations to the Fund."

On occasion in recent years (e.g., the Dominican Republic (1991)) when access has been requested concurrently under the CCFF and under a Fund arrangement in the upper credit tranches, concerns have arisen about a member's capacity to repay the Fund, particularly where a member has had a weak record of policy implementation, or there were recent arrears to the Fund. In its present form, however, paragraph 9 of the CCFF Decision allows the Fund to reduce the access under the CCFF below the access specified in paragraph 12 (or paragraph 36 of the cereal component) on capacity to repay considerations only when the CCFF purchase is not accompanied by a Fund arrangement. When a CCFF purchase and a Fund arrangement are requested concurrently, capacity to repay considerations could warrant a reduction of access, but this reduction would have to start with the Fund arrangement and would affect access under the CCFF only after access under the accompanying arrangement had been fully reduced.

The ability to reduce access under the CCFF on capacity to repay considerations without first reducing the amount of the accompanying arrangement would, in effect, be a reallocation of access from the CCFF to the arrangement and would replace the rule of automaticity of paragraph 12 by a rule of setting of access under the CCFF on a case-by-case basis whenever there are capacity to repay concerns. When the Board discussed the establishment of the CCFF in 1988, it decided against the setting of CCFF access on a case-by-case basis, preferring instead the tranching approach ultimately incorporated in paragraph 12. The Fund is, thus, in the unsatisfactory situation of having less scope for determining prudent access levels when considering concurrent requests for compensatory financing and a new Fund arrangement than when considering separate requests. Thus, a review of the effect of the capacity to repay provision of the CCFF Decision merits consideration.

The phasing, performance criteria, and program reviews under an upper credit tranche arrangement enhance the security of Fund resources. A more positive assessment of capacity to repay would therefore be possible in a situation where Fund resources are disbursed in line with policy implementation, compared to large disbursements of the same magnitude; in the latter situation, there might not be a corresponding assurance that capacity to repay would over time be strengthened sufficiently to warrant the contemplated access. Considerations relevant to an assessment of capacity to repay would include the prospective stance and strength of adjustment policies not only during the period of a Fund-supported program, but also during the post program period and while Fund resources were outstanding; the external economic environment; prospective scheduled debt service payments to the Fund and other multilateral institutions as well as to other creditors; and the possible emergence of financing gaps over the medium term, particularly during the period of peak repayments to the Fund. The member's past record in implementing Fund arrangements and sustaining appropriate policies beyond the arrangement period (e.g., avoidance of stop/go policies) would influence any judgment on the impact of likely policy performance on capacity to repay the Fund. At that same time, it must be borne in mind that assessments of capacity to repay are inevitably a matter of judgment and precise limits to access cannot readily be derived from medium-term projections alone. Capacity to repay assessments are in most cases unlikely to provide a basis for very fine judgments on prudent access levels.

The staff would propose that the CCFF Decision be amended to permit compensatory access to be limited on capacity to repay grounds, in situations of concurrent requests for compensatory financing and for a Fund arrangement, without having to first reduce the amount of the arrangement itself. In practice, this could entail an assessment of the member's capacity to repay in light of the overall level of access to compensatory financing and under the Fund arrangement although, unlike the present situation, compensatory access might be limited and access under the arrangement maintained and rephased. In the event, the staff report supporting the concurrent requests for a compensatory purchase and a Fund arrangement would lay out clearly the basis for the assessment of the limited capacity to repay the Fund and the Executive Board would need to concur.

d. Cooperation and Fund arrangements

Unless the member's record of cooperation with the Fund had not been satisfactory, a member's maximum access to compensatory financing is 82 percent of quota (joint access under the export and cereals components) in conjunction with the approval of Fund arrangement in the upper credit tranches (or current and prospective policies met the criteria for such arrangements), or where a member has such an arrangement under which performance is broadly satisfactory. As long as these and other relevant conditions of the facility are met, a compensatory purchase could thus be made at any time during the period of the Fund arrangement. In a recent case (Honduras), compensatory financing equivalent to 65 percent of quota was provided on the basis of a Fund arrangement in the upper credit tranches that expired only a few days after approval of the request for compensatory financing. The Board considered this request at the time it was also completing a review of the stand-by arrangement in the upper credit tranches that made possible the final purchase under the arrangement. Several

Directors suggested that in approving a compensatory purchase so late in the arrangement period, the letter of the CCFF Decision had been met, but that its spirit may have been breached.

From 1982 to October 1992, the Fund approved 31 CCFF requests based on an existing upper credit tranche arrangement. In five cases (including Honduras), less than three months remained under the arrangement, but in all but one case, there were still performance criteria to be observed or reviews to be completed. Moreover, in three cases (including Honduras), a new Fund arrangement was approved within six months of the CCFF drawing. Completion of a review under an upper credit tranche arrangement would seem sufficient basis to justify a compensatory purchase under the upper cooperation limits--performance is judged broadly satisfactory under the Fund arrangement in the upper credit tranches. To the extent that a problem exists, it would seem to lie not with the cooperation requirements under the CCFF Decision or their interpretation, but rather in completing a program review so late in the arrangement period. In the staff's view, the CCFF provisions have operated without undue difficulties and their modification would not seem warranted at this time. The staff will also endeavor to avoid, if possible, completing reviews in the final stages of an arrangement, particularly when associated with a compensatory purchase.

e. Determination of compensable amount

In determining the size of a compensable amount, the value of projected exports in the two post-shortfall years is limited to 20 percent above the value of exports in the two pre-shortfall years. This "20 percent rule" was introduced in July 1988 in light of concerns about sharp increases in exports in the shortfall year observed during the period 1979-87 and the possible implications of overly optimistic projections of exports earnings during the post-shortfall period. A limit on export earnings projected for the post-shortfall years was adopted by the Executive Board as an appropriate remedy in the expectation that compensatory purchases would then follow more closely the spirit of the CFF while leaving core cases unaffected. In setting a limit at 20 percent, account was taken of the prevailing price trends of exports; the annual average increases for the five year period 1988-92 in the world prices of manufactures and non oil commodities were projected at 4 1/4 percent and 4 percent, respectively. 1/ It was agreed that the specific limit of 20 percent was contingent on world price developments and would be subject to periodic review. 2/

1/ World Economic Outlook, April 1988.

2/ "Chairman's Summing Up of the Discussions on the Compensatory and Contingency Financing Facility" (Buff/88/133, EBM/88/105, 7/15/88, paragraph 17(a).)

At the first such review in 1990, the 20 percent limit was not changed. In the period 1990-92, the 20 percent rule limited the compensable amount in four of 17 cases (22 percent). This is a higher rate than that experienced from August 1988 to December 1989 (14 percent, or one of seven), but both rates are below the estimated one third of purchases that would have been affected if the 20 percent rule had been in place during 1979-87. The staff has once again examined export price projections for manufactures and non fuel primary commodities made in connection with the most recent WEO round (2 3/4 percent and 3 1/2 percent per annum for 1993-97, respectively) and finds no compelling reason to propose a change in the 20 percent limit at this time. Recent experience also does not suggest that this feature of the CCFF needs to be changed. The staff therefore proposes no change in the 20 percent limit at this time.

f. Temporariness and systemic change

A basic feature of the compensatory element is that it addresses developments in exports that are temporary and largely beyond the control of the authorities. In 1991, it was considered that former members of the CMEA did not qualify for compensatory financing related to their export shortfalls, as such shortfalls were judged to stem primarily from a major and permanent change in their economic regime, following the breakdown of the CMEA. It was noted that as the recovery of exports depended on member countries undertaking appropriate macroeconomic and structural adjustment policies, Fund support could more appropriately be provided under stand-by or extended arrangements. More recently, a second systemic shock has taken place--the breakup of the former Soviet Union and collapse of its economic system--with considerable further disruption to trade flows, including interrepublican flows. 1/

In principle, when considering a request for compensatory financing, an attempt could be made to differentiate among individual export categories according to whether the shortfall in exports of that category was temporary or not; the total compensable export shortfall could then be defined as the sum of the shortfalls that could be considered temporary. Since the establishment of the compensatory facility, this course has not been followed in practice. Even in cases where part of an export shortfall has been attributable to circumstances that were judged not to be temporary or

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1/ In contrast, excesses in oil imports costs were considered to be temporary, as they resulted primarily from higher international prices owing to the Middle East crisis; consequently, access to the oil element for former members of the CMEA was unaffected. In these cases export performance was reviewed to check whether export excesses had arisen that might need to be netted against oil import excesses. In none of these cases was there a calculated export excess for total exports. However, in all five of these cases, oil exports were netted against oil imports by deducting the crude oil equivalent of exports of refined products from oil imports.

beyond the control of the authorities, compensation has been provided on the basis of the total shortfall once a judgment was made that the total shortfall was "largely" temporary and beyond the control of the authorities (e.g., Indonesia (1983), and Dominican Republic (1991)). This practice avoids difficult issues of judgment and quantification that would arise if fine distinctions were to be made, having immediate and direct implications for access to the CCFF.

The duration of the downturn in production and exports associated with the systemic transformation of the economies in transition remains difficult to ascertain. Recently, there have been some indications that the output contraction may be bottoming out in several countries in Eastern Europe, but it is not clear whether the associated systemic decline in exports has ended. Although these countries were affected by the same external developments and at about the same time, they clearly were in different circumstances to begin with (e.g., some began the reform process earlier, had a more developed private sector and more efficient productive sector, and benefitted from stronger trading links to non-CMEA countries); the countries have responded with economic reform programs of varying strengths and comprehensiveness; and the programs have been implemented to differing degrees. Moreover, systemic effects on exports should be absent not only from the shortfall year itself but also the data for the pre-shortfall years; otherwise the calculated shortfall would be increased by the adverse effect of systemic transformation in the calculations. Against this background, it would seem evident that determination of the temporary character of a shortfall of a particular former CMEA member country, including countries of the former Soviet Union, is a matter of judgment based on a case-by-case assessment of whether the transitional period for these former CMEA member countries has been completed, with the benefit of the doubt being given to the member.

With regard to compensation related to possible cereals import excesses, in these cases the staff would recommend an approach similar to that adopted for oil import excesses. Thus, to the extent that a decline in domestic cereal production was a direct consequence of structural changes such as ownership transformation, or failure of the distribution system, compensation would not be forthcoming under the CCFF. However, if cereal imports increased following a drought or an increase in cereals import prices that was clearly identifiable as temporary and largely beyond the authorities' control, then the cereals import excess could be compensable, provided that the other conditions for a purchase were satisfied. In presenting such a request, the case for compensation would need to be laid out clearly in the staff report supporting the compensatory drawing request.

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The staff's recommendations related to the compensatory element are summarized as follows:

1. To reiterate the importance of timely requests by having the Executive Board consider a compensatory financing request within six months of the end of the shortfall/excess year subject to a brief delay not exceeding 30 days;

2. To require phasing for compensatory purchases in cases where estimated data were used for nine months or more of the compensable year. The first purchase under such a phased drawing procedure would be 65 percent of the calculated access. Once six months of actual data became available, the compensable amount would be recalculated based on updated estimates for the shortfall years and revised projections for the post shortfall years. A second purchase could be made for up to the recalculated amount subject to cooperation and access limits.

3. To retain the present method for final calculation of the compensable amount under the early drawing procedure. For multiple purchases, only one final calculation would be necessary based on the post-shortfall projections used for the latest purchase.

4. To provide that, should a member fail to meet a prompt repurchase expectation arising with respect to a purchase under the CCFF, the member's right to make further purchases under an existing Fund arrangement would be suspended and the Managing Director would not recommend approval by the Executive Board of any request for additional use of Fund resources.

5. To permit the import content of exports to be netted against an export shortfall, in those cases where there is a large, direct, and easily measured import content (e.g., exports of petroleum and products, cut diamonds, and in-bond industries).

6. Clarification of the capacity to repay provision (paragraph 9), to permit access to CCFF resources to be limited, if deemed appropriate, by the Executive Board without having necessarily to reduce first the amount under the Fund arrangement to zero.

7. The 20 percent rule--limiting the value of projected exports in the two post-shortfall years to 20 percent above the value of exports in the two pre-shortfall years--has been reviewed and no change is proposed.

8. Determination on a case-by-case basis whether member countries (in particular former CMEA members) export shortfalls can be regarded as temporary, when the export performance in the pre-shortfall years does not reflect systemic changes any longer; the benefit of the doubt would be given to the member in making this assessment.

Table 1. Fund Arrangements with External Contingency Mechanisms under the CCFF, 1989-1992 1/

Country	Arrangement			Maximum Amount			Baseline Period (In months)	Threshold (In percent of Quota)	Contingency Purchases in Millions of SDRs	Symmetry Provision Triggered
	Type	Date of Approval	Amount in Millions of SDRs	In Millions of SDRs	In percent of the Amount of Arrangement	In Percent of quota				
Trinidad and Tobago	SBA	Jan. 1989	99.0	42.5	43	25	Oct.88-Dec.89 (15)	10	--	Yes
Philippines	EA	May 1989	660.6	286.3 3/	43 3/	65 3/				
First year			188.7	110.1	58	25	Apr.89-Mar.90 (12)	15	--	No
Trinidad and Tobago	SBA	Apr. 1990	85.0	42.5	50	25	Jan.90-Dec.90 (12)	10	--	Yes
Czechoslovakia	SBA	Jan. 1991	619.5	147.4	24	25	Jan.91-Dec.91 (12)	20	--	Yes
Hungary	EA	Jan. 1991	1,114.0	299.5 3/	27 3/	56 3/				
First year			477.6	159.2	33	30	Jan.91-Dec.91 (12)	30	--	No
Second year *		Mar. 1992 2/	318.4	159.2	50	30	Jan.92-Dec.92 (12)	30	...	...
Philippines	SBA	Feb. 1991	264.2	88.0	33	20	Jan.91-Jun.92 (18)	15	...	Yes
Bulgaria	SBA	Mar. 1991	279.0	77.6	28	25	Jan.91-Dec.91 (12)	20	56.9	No
Romania	SBA	Mar. 1991	380.5	130.9	34	25	Apr.91-Mar.92 (12)	20	--	No
Costa Rica	SBA	Apr. 1991	33.6	21.0	62	25	Jan.91-Dec.91 (12)	10	--	No
Poland	EA	Apr. 1991	1,224.0	442.0 3/	36 3/	65 3/				
First year			306.0	170.0	56	25	Jan.91-Dec.91 (12)	20	--	No
Algeria	SBA	Jun. 1991	300.0	210.0	70	34	Jan.91-Dec.91 (12)	45	--	No

Source: Executive Board documents.

1/ Through end-November 1992. Operative ECMs are indicated with asterisks (*).
2/ Date of approval of ECM for second year of extended arrangement.
3/ Total commitment for the multiyear arrangement.

Table 2. In-Built Contingency Mechanisms in Fund-Supported and Fund-Monitored Programs, 1990-92 1/

	Arrangement				Contingency Mechanism			
			Amount					
Country	Type	Program Period	In Millions of SDRs	In Percent of Quota	Baseline Period (In months)	Threshold (In percent of quota)	Nature of Mechanism	Mechanism Triggered
Algeria	SBA	06/03/91-03/31/92	300.0	48	Apr. 91 - Dec. 91 (9)	--	Symmetric	Yes
Burundi	ESAF	07/01/91-06/30/94	42.7	100				
First annual program*					July 91 - Dec. 92 (18)	--	Symmetric	No
Ecuador	SBA	12/11/91-12/10/92	75.0	50	Oct. 91 - Sep. 92 (12)	6.25/12.5/18.75/25	Symmetric	Yes
Gabon	SBA*	09/30/91-03/29/93	28.0	38	July 91 - Dec. 91 (6)	--	Symmetric	Yes
Guinea	ESAF	07/01/91-06/30/94	57.9	100				
First annual program					July 91 - June 92 (12)	--	Asymmetric	No
Lesotho	ESAF	05/22/91-05/21/94	18.1	120				
First annual program					Apr. 91 - Mar. 92 (12)	--	Symmetric	No
Second annual program*					Apr. 92 - Mar. 93 (12)	--	Symmetric	...
Mexico	EA	05/26/89-05/25/93	2,797.2	240				
Second annual program					Jan. 90 - Dec. 90 (12)	10.5/21/31.5/42 2/	Symmetric	Yes
Third annual program					Jan. 91 - Dec. 91 (12)	16/32/48/64 2/	Symmetric	Yes
Fourth annual program*					Jan. 92 - Dec. 92 (12)	15 2/	Symmetric	Yes
Nigeria	SBA	01/09/91-04/08/92	319.0	38	Oct. 90 - March 91 (6)	--	Asymmetric	No
Sierra Leone	RAP	04/03/92-02/28/94	87.3	151			Asymmetric	No
First annual program*					Apr. 92 - Jun. 92 (3)	3		
Venezuela	EA	06/23/89-03/22/93	3,701.0	270				
Second annual program					Jan. 90 - Dec. 90 (12)	72	Symmetric	Yes
Third annual program					Jan. 91 - Dec. 91 (12)	101	Symmetric	Yes
Zambia	RAP	04/17/91-04/16/94	836.9	310				
First annual program					Jan. 91 - Dec. 91 (12)	--	Asymmetric	Yes
	RAP	07/17/92-07/16/95	836.9	310				
First annual program*					June 92 - Dec. 92 (6)	--	Asymmetric	Yes
Zimbabwe	EA	06/24/92-01/23/94	343.8	180				
First annual program					Jan. 92 - Dec 92 (12)	7	Asymmetric	No

Source: Executive Board documents.

1/ Through end-November, 1992. Operative ICMs are indicated with asterisks.

2/ Cumulative thresholds. Applicable only for higher than projected oil prices; no threshold on downside.

Table 3. External Contingency Mechanisms: Coverage, Adjustment and Financing

	Covered Variables	Targets or Performance Criteria Affected by Adjustment	Percent of Deviation to be Financed
Trinidad & Tobago (1989)	Export prices of crude oil and petroleum products; interest rate on variable rate external debt (including repurchase obligations to the Fund), net of receipts on international reserves.	In the event the symmetry provision was triggered, the NIR target was to be increased by 75 percent of cumulative net sum of deviations (after deduction of 4 percent of quota) in the first quarter when the threshold was exceeded; in subsequent quarters this proportion would be reduced in the same manner as the financing proportions. In the event the contingency mechanism was triggered, the authorities were to consult with the Fund on the appropriate adjustments of the quantitative program targets and performance criteria, and on such policy adaptations as may be necessary to attain the objectives of the program supported by the SBA.	75 percent for the cumulative net sum of deviations (after deduction of 4 percent of quota) in the first quarter in which net sum of deviations exceeded the threshold; reduced by 25 percentage points in each subsequent quarter. Financing proportion remained at 75 percent to the extent that the net sum of deviations in any subsequent quarter exceeded the largest net sum of deviations in any previous quarter. A maximum of 2 percentage points applied to the increase in interest rates on variable rate external debt that would be taken into account in calculating the net sum of deviations.
Philippines (1989)	Export prices of coconut oil, copper metal and copper concentrate; partner countries' volume of non-oil imports; import prices for petroleum and petroleum products; partner countries' non-oil export prices; and interest payments on net external debt at variable interest rates.	In the event the symmetry provision was triggered, the NIR target was to be increased by 50 percent of the net sum of deviations (after deduction of 4 percent of quota) in the initial semester; in subsequent semesters this proportion would be reduced in the same manner as the financing proportion. In the case of unfavorable deviations, the floor on NIR, the ceiling on the borrowing requirements of the monitored public sector, and the limit on external nonconcessional borrowing were to be adjusted by appropriate amounts, in light of the magnitude of the contingency, and the contingency financing available from commercial banks.	50 percent of the cumulative net sum of deviations (after deduction of 4 percent of quota) in the initial semester; in the subsequent semester, financing of the net sum of deviations was to be reduced by 20 percentage points to the extent that deviation was equal to or less than in the previous semester. Financing proportion remained at 50 percent to the extent that the net sum of deviations was greater than in the previous semester.

Table 3 (continued). External Contingency Mechanisms: Coverage, Adjustment and Financing

	Covered Variables	Targets or Performance Criteria Affected by Adjustment	Percent of Deviation to be Financed
Trinidad & Tobago (1990)	Export prices for crude petroleum, petroleum products, methanol, urea, steel (wire rods); variable interest rates on external debt (including use of Fund credit) net of interest receipts on foreign exchange holdings by the central bank.	In the event the symmetry provision was triggered, the program target for NIR was to be increased by 75 percent of the cumulative net sum of deviations (after deduction of the threshold), declining by 25 percentage points in each subsequent quarter. If the positive quarterly net sum of deviations in any subsequent quarter exceeded the largest positive quarterly net sum of deviations in any previous quarter, the buildup of NIR would be 75 percent of the excess and would be reduced by 25 percentage points in each following quarter. The net domestic assets target would be adjusted correspondingly. In the event of unfavorable deviations, the authorities were to consult with the Fund on the appropriate adjustment of the quantitative program targets and performance criteria, and on such policy adaptations as might be necessary to attain the objectives of the program supported by the SBA. The target for NIR was to be adjusted by an amount equal to the financing provided by the Fund under the CCFF. The ceiling on the net domestic assets, the limit on the overall central government deficit, and the ceiling on net credit of the financial system to the non financial public sector would be adjusted by appropriate amounts.	75 percent of the cumulative net sum of deviations (after deduction of 4 percent of quota) to be provided in the quarter in which the contingency mechanism is triggered; reduced by 25 percentage points in each subsequent quarter. Financing proportion remained at 75 percent to the extent that the net sum of deviations in any subsequent quarter exceeded the largest quarterly net sum of deviations in any previous quarter. A maximum of 2 percentage points applied to the increase in interest rates on variable rate external debt that would be taken into account in calculating the net sum of deviations.
Czechoslovakia (1991)	Import prices of crude petroleum and natural gas.	In the event the symmetry provision was triggered, the NIR target was to be increased by 100 percent of the cumulative net sum of deviations after deduction of the threshold; falling to 50 percent in subsequent quarters. The Fund was to be consulted in the formulation of adjustment measures to absorb adverse contingencies not financed by the Fund.	100 percent of the cumulative net sum of deviations after deduction of the threshold, 50 percent of the quarterly net sum of deviations in each subsequent quarter.

Table 3 (continued). External Contingency Mechanisms: Coverage, Adjustment and Financing

	Covered Variables	Targets or Performance Criteria Affected by Adjustment	Percent of Deviation to be Financed
Hungary (1991, 1992) 1/	Export prices on sales of non-petroleum exports to all countries other than former members of CMEA; prices of non-petroleum merchandise imports from non-CMEA countries; the price of net trade in petroleum and petroleum products; variations in non-CMEA partner countries' import demand; interest payments on convertible currency external debt at variable rates, less interest earnings on the convertible currency floating rate international assets. Not covered by interest rate caps/swaps.	If the threshold is exceeded in a positive direction this would trigger a special review. It is expected that 70 percent of the cumulative net sum of deviations after deduction of the threshold would be added to the NIR during the first semester in which the contingency mechanism is triggered. In subsequent periods this proportion would be determined in the same manner as the financing proportion. The ceiling on NDA would be adjusted by an appropriate amount. If the country experiences a favorable net sum of deviations following an earlier period in which contingency financing has been provided, Hungary will use the increase in the required level of NIR to repurchase promptly purchases made under the contingency mechanism. In the event of unfavorable deviations, the floor on NIR and the ceiling on NDA will be adjusted by appropriate amounts in the light of the magnitude of the contingencies, their expected duration, the likely timing of the impact of policy measures, and the availability of contingency financing from other sources.	70 percent of the cumulative net sum of deviations (after deduction of the threshold) to be provided in the semester in which the contingency mechanism is triggered. In the next two quarters, financing proportion to be reduced by 40 percentage points to the extent that the deviation is equal or less than in the previous semester. Financing proportion remains at 70 percent to the extent that the net sum of deviations in any subsequent semester is greater than in the previous semester.
Philippines (Jan.1991-Jun.1992)	Export prices for coconut oil 2/, copper metal, copper concentrate; import prices for petroleum and petroleum products; variable interest rates on external debt. 3/	If the symmetry provision was triggered, the NIR target was to increased by 60 percent of the cumulative net sum of deviations after deduction of the threshold. In subsequent quarters, this proportion would be reduced in the same manner as the financing provided in the case of net unfavorable deviations. In the event of unfavorable deviations, the floor on NIR, the ceiling on public sector borrowing, and the limit on nonconcessional borrowing were to be adjusted by appropriate amounts in light of the magnitude of the contingency financing available from commercial banks.	60 percent of the cumulative net sum of deviations after deduction of the threshold in the first quarter, declining by 20 percentage points in subsequent quarters. Financing proportion to remain at 60 percent to the extent that the net sum of deviations in any subsequent quarter exceeded the amount in the previous quarter. The change in interest rates taken into account in calculating the net sum of deviations will be limited to 2 percentage points during the base line period.

Table 3 (continued). External Contingency Mechanisms: Coverage, Adjustment and Financing

	Covered Variables	Targets or Performance Criteria Affected by Adjustment	Percent of Deviation to be Financed
Bulgaria (1991)	Import prices of crude petroleum and natural gas.	In the event of deviations exceeding the threshold, the authorities were to discuss with the Fund staff adjustment to the program's targets. In the event of a favorable deviation, the NIR target was to be increased by 100 percent of the cumulative net sum of deviations after deduction of the threshold; in subsequent quarters the proportion was to be reduced in the same manner as the financing proportion.	100 percent of the cumulative net sum of deviations (after deduction of the threshold) in the first quarter in which the contingency mechanism was triggered. Reduced to 50 percent in each subsequent quarter. Financing proportion was to remain at 100 percent to the extent that the net sum of deviations in any subsequent quarter exceeded that in the previous quarter.
Romania (Apr.1991-Mar.1992)	Import prices of crude petroleum and natural gas.	In the event of deviations exceeding the threshold, the authorities were to discuss with the Fund staff adjustment to the program's targets. In the event of a favorable deviation, 100 percent of the cumulative net sum of deviations (after deduction of the threshold) was to be added to NIR; in subsequent quarters the proportion was to be reduced in the same manner as the financing proportion.	100 percent of the cumulative net sum of deviations (after deduction of the threshold) in the first quarter in which the contingency mechanism was activated. Reduced to 50 percent in each subsequent quarter. Financing proportion was to remain at 100 percent to the extent that the net sum of deviations in any subsequent quarter exceeded that in the previous quarter.
Costa Rica (1991)	Import prices of crude and refined oil products; export prices for coffee.	In the event of deviations exceeding the threshold, the authorities were to discuss with the Fund staff adjustments to the program's targets. In the event of a favorable deviation, the Fund was to determine if Costa Rica's reserves would be increased (the preferred option) or if the amount of the associated arrangement would be reduced or a combination of both, by an amount that would not exceed the maximum financing available in the event of a corresponding unfavorable net sum of deviations. 80 percent of the cumulative net sum of deviations after deduction of the threshold was to be added to the NIR target. In subsequent quarters this proportion was to be reduced in the same manner as the financing proportion. Ceiling on NDA to be adjusted correspondingly.	80 percent of the cumulative net sum of deviations after deduction of the threshold were to be financed in the quarter in which the contingency mechanism was activated. Reduced to 40 percent for each subsequent quarter. Financing proportion to remain at 80 percent to the extent that the net sum of deviations exceeded the amount in the previous quarter.
Poland (1991)	Import prices of crude petroleum and natural gas; import and export prices of petroleum products.	In the event of deviations exceeding the threshold, the authorities were to discuss with the Fund staff adjustment to the program's targets. In the event of favorable deviations, it was expected that 80 percent of the cumulative net sum of deviations after deduction of the threshold would be added to the NIR target, and that in each subsequent quarter this proportion would be determined on the same basis as the financing proportion.	80 percent of the cumulative net sum of deviations after deduction of the threshold in the first quarter after the contingency mechanism is triggered. Reduced to 50 percent in subsequent quarters. Financing proportion was to remain at 80 percent to the extent that the net sum of deviations in any subsequent quarter exceeded the amount in the previous period.

Table 3 (concluded). External Contingency Mechanisms: Coverage, Adjustment and Financing

	Covered Variables	Targets or Performance Criteria Affected by Adjustment	Percent of Deviation to be Financed
Algeria (1991)	Export prices of crude oil, petroleum products, and natural gas.	In the event of deviations exceeding the threshold, the authorities were to discuss with the Fund staff adjustment to the program's targets. Positive deviations in excess of the threshold were to trigger discussions of adjustments to the underlying program. It was expected that the NIR target would be increased by 50 percent of the cumulative net sum of deviations after deduction of the threshold, in addition to the adjustment required under the in-built contingency mechanism. In the case of unfavorable deviations, the floor on NIR would remain unchanged on account of the external contingency mechanism, but this and other performance criteria would be adjusted in accordance with the in-built contingency mechanism.	50 percent of the cumulative net sum of deviations after deduction of the threshold in the first quarter in which the threshold was exceeded. In subsequent quarters, the proportion financed under the ECM was to be 50 percent of the cumulative net sum of deviations to the extent that it exceeded the level of the cumulative net sum of deviations on which the previous external contingency mechanism drawing was based.

Source: Executive Board documents.

1/ Coverage of non petroleum export earnings and import prices was dropped from the external contingency mechanism attached to the second annual arrangement; otherwise, this ECM has the same features as the ECM attached to the first annual arrangement.

2/ Because the Philippines is a large exporter of coconut oil, if the actual volume of coconut exports in the quarter in which a price deviation occurred deviated by more than 10 percent from the projected volume, the actual price rise used in calculating the deviation was to be raised (lowered) by one third of the percentage change by which the volume is higher (lower) than projected.

3/ Non-oil import volume growth in partner countries, and non oil export unit values in partner countries were dropped because experience indicated that WEO estimates of these variables did not necessarily provide good indicators for shifts in world demand and for changes in the prices of imports.

Table 4. In-built Contingency Mechanisms: Coverage, Adjustment and Financing

	Covered current account variables	Targets or Performance Criteria Affected by Adjustment	Adjustments of targets or performance criteria and caps.
Algeria (1991)	Hydrocarbon prices: oil and gas export prices	Minimum balance on treasury operations, credit to the Central Government, net domestic assets, net international reserves, and ceiling on disbursements of medium- and long-term debt	Target on net international reserves and ceiling on disbursements of medium- and long-term debt to be adjusted by 33 percent of the cumulative deviation in hydrocarbon prices (after first deducting ECM drawings or symmetry adjustments). Other performance criteria to be adjusted by an amount in millions of dinars equivalent to the cumulative sum of export deviations expressed in millions of US dollars multiplied by 14.3. 1/ If the sum of deviations is negative, the adjustment is limited to minus DA 5.7 billion, corresponding to a negative US$400 million export deviation or 45 percent of quota, the threshold for the ECM. In the event of positive deviations the maximum adjustment is to be capped at DA 10.1 billion (80 percent of quota) for end-September 1991 and at DA 25.3 billion (200 percent of quota) for end-December 1991.
Burundi (1991)	Coffee export price	Net foreign assets, net domestic assets of the banking system, net credit to the central government.	Deviations are calculated in respect of movements in the world market price for coffee relative to a baseline forecast for 1991-92. For prices lower than anticipated, targets for net foreign assets will be reduced by 40 per cent of the deviation; targets for net credit to the government and net domestic assets will be increased by corresponding amounts. In the event of higher than expected prices, targets will adjusted by the full magnitude of the deviation. Adjustments are capped in respect of adverse contingencies by a minimum floor (expressed in US dollars) for the targets for net foreign assets; adjustments in respect of favorable contingencies are not capped.
Ecuador (1991)	Oil export price; interest payments to foreign commercial banks.	Net domestic assets of the Central Bank, net credit to the nonfinancial public sector by the Central Bank, net international reserves of the Central Bank.	Performance criteria to be adjusted by 100 percent of the deviations in export earnings arising from oil prices that exceed baseline prices by more than US$0.75/barrel (equivalent to US$50 million or 24 percent of quota an annual basis). If oil prices are lower than expected, the targets can be relaxed up to a maximum of US$50 million or 24 percent of quota an annual basis. Performance criteria also to be adjusted by 100 percent of deviations in external interest payments to commercial banks.
Gabon (1991)	Oil price	Net domestic assets of the banking system, net bank claims on the Central Government	In case of negative deviations from baseline for up to US$2 a barrel; for deviations in excess of US$2 a barrel, to be determined in the context of a consultation with the Fund; in case of positive deviations, excess oil reserves to be deposited in a reserve fund, the use of which to be discussed during program reviews.

Table 4 (continued). In-built Contingency Mechanisms: Coverage, Adjustment and Financing

	Covered current account variables	Targets or Performance Criteria Affected by Adjustment	Adjustments of targets or performance criteria and caps.
Guinea (1992)	Price of refined petroleum products.	Net foreign assets of the Central Bank, net domestic assets of the banking system and net bank credit to the government.	Performance criteria to be adjusted for 100 percent of favorable deviations in the f.o.b. price of refined petroleum products from the program baseline of US$200 per metric ton, provided they are not offset by unfavorable deviations in gross inflows in official grants and concessional medium- and long-term loans (including debt rescheduling). Deviations in petroleum prices to be evaluated at the volume of imports assumed in the program baseline. No adjustments to be made for net sum of unfavorable deviations.
Lesotho (1991-93)	Workers' remittances/workers' remittances and commercial grains imports. 2/	Net international reserves, net domestic assets of the Central Bank and net credit to the government	Performance criteria to be adjusted by 100 percent of the unfavorable deviations in workers' remittances for up to SDR 9 million under the first annual program and for unfavorable deviations in workers' remittances and commercial grain imports for up to SDR 20 million under the second annual program. Performance criteria to be adjusted by 100 percent of favorable deviations in both cases.
Mexico (1990-92)	Oil price	Net international reserves and net domestic assets of the Central Bank; net credit to the nonfinancial public sector; public sector borrowing requirement; primary surplus of the nonfinancial public sector; operational surplus of the nonfinancial public sector	Under the third annual arrangement, performance criteria to be adjusted if the cumulative additional oil export revenue resulting from higher than projected oil prices exceeded US$1 billion on an annual basis (equivalent to 64 percent of quota or US$2 a barrel). An increasing proportion of receipts to be saved as export prices rise; the increments above a deviation of US$4 a barrel (equivalent to 127 percent of quota) to be saved fully and the programmed minimum improvement in net international reserves to be adjusted accordingly. In the case of negative deviations up to US$2 a barrel (equivalent to 64 percent of quota), full adjustment of performance criteria required. With widening deviations, the program envisaged smaller downward adjustments of foreign reserves; full policy adjustment was required if deviations exceeded US$4 a barrel (equivalent to 127 percent of quota). The maximum foreign reserve downward adjustment was US$1,375 million for 1991 (equivalent to 88 percent of quota). A similar ICM was designed for the fourth-year annual arrangement.3/
Nigeria (1991)	Oil price	Net foreign assets of the Central Bank, net credit of the banking system, net bank credit to the Government.	Performance criteria to be adjusted by 100 percent of the deviation in export earnings arising from higher than expected oil prices. In case of deviations of up to US$1 a barrel (equivalent to 45 percent of quota on an annual basis), one half of the windfall gains could be used for priority projects and the other half to reduce the Federal Government's financing requirements or to offset any shortfalls in foreign financing. All increases greater than US$1 a barrel to be used to reduce the overall budgetary deficit.
Sierra Leone (1992)	Foreign exchange earnings from exports of rutile, bauxite, fisheries, and diamonds	Net international reserves and net domestic assets of the Central Bank	The floor on net international reserves to be adjusted upwards by the sum of one third of the excess over the program's export revenue projections, and one tenth of the excess over official diamond exports in the preceding quarter. Performance criteria for net domestic assets to be adjusted accordingly.

Table 4 (concluded). In-built Contingency Mechanisms: Coverage, Adjustment and Financing

	Covered current account variables	Targets or Performance Criteria Affected by Adjustment	Adjustments of targets or performance criteria and caps.
Venezuela (1990-92)	Oil export earnings	Net international reserves and public sector borrowing requirement	During 1990 performance criteria to be adjusted by 100 percent of excess net of the deductible of US$1,300 (equivalent to 72 percent of quota). In 1991, the adjustment equals 75 percent of cumulative excess. In the event that the cumulative excess of oil export receipts falls in any given quarter, withdrawals from the oil contingency fund are triggered (which are equal to 25 percent of the shortfall) in that particular quarter. Withdrawals from the fund during any given quarter cannot exceed 25 percent of the level of the fund at the start of the quarter. Performance criteria for overall public sector borrowing requirement and net international reserves to be adjusted accordingly. For the period September-December 1991, the methodology to be used for calculating the oil contingency adjustment was modified. The value of local currency deposits in the contingency fund at the end of September and December 1991 was defined as the stock of deposits in U.S. dollar terms using a higher deductible of US$1,922 million (equivalent to 101 percent of quota) for the baseline scenario in 1991 to account for deficiencies in the mechanism observed in 1990. To achieve the required stock at end-1991, a phased reconstitution of deposits in the Oil Contingency Fund was established as a performance criterion for September and December 1991. The required stock to be adjusted upward (downward) in case of deviations of oil export receipts from programmed levels.
Zambia (1991, 1992)	Copper export and oil import prices	Net international reserves	During 1991, performance criteria to be adjusted upward by 100 percent of the amount of any excess in copper earnings (measured at baseline volumes) resulting from copper prices above baseline assumptions less (a) 90 percent of the additional oil bill (measured at average 1987-89 oil volumes) that results from an oil price above the baseline level; and less (b) 100 percent of any shortfall in donor assistance, with a limit of 26 percent of quota. Fifty percent of any net excess above this limit to be used to make additional payments to the Fund. The floor on net international reserves to be adjusted upward to reflect the higher gross reserves objective, as well as any further reduction in arrears to the Fund. For 1992, performance criteria to be adjusted for excess copper earnings net of 100 percent of any shortfall in donor assistance. Limit for full adjustment of performance criteria reduced to 10 percent of quota.
Zimbabwe (1992)	Gold and tobacco export prices, and oil import prices	Net international reserves and net domestic assets of the Central Bank	Adjustment for adverse deviations only. Deviations in excess of the threshold in any quarter lead to an adjustment of performance criteria by 100 percent in that quarter, and by 50 percent in the following quarter. These adjustments are to be capped at 32 percent of quota, making sure that the level of gross international reserves does not fall below US$330 million (two months of imports). Adjustment policies to be strengthened so as to restore the original NIR targets within 2 quarters.

Source: Executive Board documents.

Table 5. Compensatory Financing Purchases, 1990-1992

(In million of SDRs, unless otherwise specified)

Country	Date of Purchase	Calculated Amounts: Export Shortfall	Calculated Amounts: Oil Import Excess	Calculated Amounts: Shortfall/ Excess	Purchases: Export Shortfall	Purchases: Oil Import Excess	Purchases: Total Purchase	Purchases: In percent of Quota	Outstanding CCFF Drawing after Purchase (In percent of quota)
Papua New Guinea	May 1, 1990	97.0	--	97.0	42.8	--	42.8	(65.0)	(65.0)
Côte d'Ivoire	Sep 13, 1990	194.0	--	194.0	24.8	--	24.8	(15.0)	(65.0)
1990 Subtotal					67.7	--	67.7		
Czechoslovakia	Jan 10, 1991	1,480.0 1/	557.0	2,037.0	--	314.5	314.5 2/	(53.3)	(53.3)
Hungary	Jan 22, 1991	823.0 1/	348.0	1,171.0	--	226.2	226.2 2/	(42.6)	(42.6)
India	Jan 23, 1991 (*)	-314.5 4/	1,031.3	716.9	--	716.9	716.9	(32.5)	(32.5)
Philippines	Feb 25, 1991 (*)	318.3	171.2	489.5	105.9	171.2	277.1	(62.9)	(82.0)
Jamaica	Feb 27, 1991	-7.0	37.6	30.6	--	19.9	19.9 2/	(13.7)	(31.3)
Bulgaria	Feb 28, 1991	1,159.0 1/	93.2	1,252.2	--	60.6	60.6 2/	(19.5)	(19.5)
Romania	Mar 20, 1991	1,352.0 1/	247.7	1,599.7	--	209.4	209.4	(40.0)	(40.0)
Costa Rica	Apr 11, 1991	26.9	27.9	54.8	5.7	27.9	33.6	(40.0)	(40.0)
Romania	Apr 16, 1991	... 5/	... 5/	... 5/	--	38.3	38.3	(7.3)	(47.3)
Poland	Apr 23, 1991	464.1	250.2	714.3	--	162.6	162.6 2/	(23.9)	(23.9)
Czechoslovakia	Jun 24, 1991	1,667.0 1/	398.0	2,065.0	--	83.5	83.5 3/	(14.2)	(67.5)
Jamaica	Jul 3, 1991 (*)	10.1	25.1	35.2	10.1	5.2	15.3 3/	(24.2)	(34.7)
India	Jul 22, 1991 (*)	429.8 4/	758.5	1,188.3	124.6	41.6	166.2	(7.5)	(40.0)
Dominican Republic	Sep 3, 1991	101.4	38.3	139.7	6.5	38.3	44.8	(40.0)	(40.0)
India	Sep 16, 1991 (*)	633.0 4/	719.0	1,352.0	468.9	--	468.9	(21.2)	(61.2)
Pakistan	Dec 19, 1991 (*)	-62.6 4/	185.0	122.4	--	122.4	122.4	(22.4)	(22.4)
1991 Subtotal					721.7	2,238.6	2,960.3		
Czechoslovakia	Jan 15, 1992	772.0 1/	466.0	1,238.0	--	103.0	103.0	(17.5)	(79.0)
Honduras	Feb 20, 1992	65.9	--	65.9	44.1	--	44.1	(65.0)	(65.0)
Barbados	Feb 12, 1992	43.5 4/	--	43.5	22.2	--	22.2	(65.0)	(65.0)
Panama	Feb 27, 1992	1.6	35.1	36.7	1.6	35.1	36.7	(35.9)	(35.9)
Hungary	Mar 26, 1992	823.0 1/	174.9	997.8	--	38.8	38.8	(7.3)	(33.0)
Israel	Apr 1, 1992	713.0 4/	--	713.0	178.6	--	178.6	(40.0)	(40.0)
Romania	Jun 15, 1992	1,281.7 1/	147.5	1,429.2	--	76.8	76.8	(14.7)	
1992 Subtotal					246.5	253.7	500.2		
Grand Total		2,142.1 6/	2,395.4 6/	4,537.5 6/	1,035.8	2,153.2 7/	3,189.0 7/	(33.8) 8/	(45.0)

Source: Fund CCFF database.
(*) Calculated shortfalls constrained by the 20 percent rule.
1/ These export shortfalls were judged not to be temporary and reversible, but instead largely the result of a major and permanent change in the economic regime, following the breakdown of CMEA trade.
2/ First purchase under the phased drawing procedure.
3/ Second drawing under the phased drawing procedure.
4/ Refers to total earnings from merchandise exports plus services, excluding investment income as applicable.
5/ Same figures as for March 1991 drawing. Further access was provided in April 1991 upon approval of a stand-by arrangement in the upper credit tranches and consequent fulfillment of cooperation requirement.
6/ Excluding export shortfalls resulting largely from a permanent change in the economic regime. Also excluding calculations for Jamaica, made at the time of first drawing under phased drawing procedure; for India at the time of the first and second purchase; and three quarters of the amounts calculated at the time of the 1991 purchase by Romania, to adjust for 9 months overlap with the shortfall year of the 1992 purchase.
7/ Net of prompt repurchases by Bulgaria (SDR 60.6 million), Czechoslovakia (SDR 35.0 million), Hungary (SDR 90.1 million), and Romania (SDR 153.4 million).
8/ Calculated treating first and second drawings under the phased drawing procedure as a single purchase.

July 15, 1988 - 88/133

Final Version of the Chairman's Summing Up of the Discussions on the Compensatory and Contingency Financing Facility Concluded at Executive Board Meeting 88/105, July 15, 1988

These remarks summarize my understanding of the agreement that has been reached on the general principles and specific modalities for the compensatory and contingency financing facility. My informal remarks of April 7, 1988 (Buff 88/68--Final Version) on the same subject form an integral part of the understandings and are included as an Appendix to this Summing Up.

At the meetings that took place in March and April of this year, broad agreement was reached on general principles and a framework for the new facility. In particular, it was concluded that the essential features of CFF should be preserved; that contingent Fund financing could help maintain the momentum of adjustment programs against adverse external shocks; and that the basic features of contingency mechanisms should include an appropriate blend of adjustment and financing, incorporate symmetry, and involve external factors beyond the control of authorities, subject to a minimum threshold level for activation. To these principles I would add the need to pursue parallel contingent financing vigorously where necessary and to ensure that programs continue to be adequately financed when Fund resources are disbursed. It is also important to stress that purchases under this facility, as under all Fund facilities, would be subject to balance of payments need and that, in providing financing under this facility, due attention will be paid to the member's capacity to meet its obligations to the Fund.

In our meetings over the past few weeks, Directors have reached agreement on a number of operational modalities for the new facility and the features of this agreement are summarized below. Directors also concluded that in order to avoid creating an unduly rigid and complex system, many detailed operational aspects of contingency financing would have to be developed with the authorities at the time each associated arrangement is framed, on an experimental and case-by-case basis. As each case comes before the Board, and is commented on by Directors, that experience will be duly reflected in subsequent cases. Then, before the 1989 Annual Meeting, there will be a general review of the compensatory and contingency financing facility based on experience with its operations.

I will now turn to the detailed modalities for the new facility.

1. Access limits for contingency mechanisms

Contingent financing would be subject to the cumulative access limits for the facility. In addition, contingent financing would not generally exceed 70 percent of access under the associated arrangement. For multiyear arrangements there would be a flexible approach for distribution of access as between years; normally, some frontloading and carryover of access would be provided for, but access in any one year would not generally exceed 70 percent of the access available under the associated arrangement in each 12-month period.

2. Activation

Contingency mechanisms would be attached to Fund arrangements and would be approved by the Executive Board at the time of the approval of the associated arrangement. Contingency mechanisms generally would be activated on the basis of a review by the Executive Board. Such reviews would normally be conducted within the context of a mid-term program review, although in some cases it might be useful to conduct an ad hoc review. Eventually, some of these reviews might occasionally be conducted on a lapse-of-time basis, but it is understood that in the early experimental stage of the new facility a discussion by the Executive Board would take place in each case.

In some exceptional cases where the link between additional financing needs and the relevant contingencies and the policy actions that would need to be phased in could be specified in advance with sufficient precision, the Executive Board could give advance approval for the disbursement of contingent financing without further Executive Board review. In such cases, the staff assessment could be expedited and, after the Board has received adequate advance notification, disbursements would be made. All purchases would of course require observance of the arrangement's performance criteria, adjusted by the Executive Board as necessary to take account of the effects of the contingencies.

3. Resources for contingent financing

Purchases for contingent financing will use ordinary resources with a repurchase period of 3-5 years. Access would be considered separate from holdings resulting from the use of Fund resources under any other policy but not from holdings resulting from purchases on account of export shortfalls or excess cereal costs. As is the case with purchases under tranche policies, purchases for contingent financing and holdings resulting from such purchases would be excluded for the purpose of determining a member's reserve tranche position.

4. Choice of the optional tranche

The optional tranche would be divisible. Prior to activation of a contingency mechanism, members would be free to choose the application of the optional tranche, except when the member requests and the Fund agrees to specify in advance an allocation of the optional tranche; it is expected that this would mainly involve cases where parallel contingent financing was being arranged. At the time of activation of the contingency mechanism, members would commit themselves on the use of the optional tranche for the remaining period of the baseline.

5. Minimum threshold

For an experimental period until the general review of the facility has been completed, the staff would work with a threshold of 10 percent of quota, but management would have the freedom to propose a lower or higher figure in what is expected to be the relatively few cases where this was necessary. Four percent of quota--an amount that is assumed to be covered as a minimum in all basic programs through appropriately flexible policies and/or financing--would be deducted before calculating the financing to be made available or before applying the symmetry procedures.

6. Proportion of deviation to be financed

The proportion of a contingent deviation to be financed would be determined on a case-by-case basis to ensure an appropriate mix of adjustment and financing and would be established at the outset of the arrangement with a contingency mechanism. In the period immediately after an adverse shock has occurred, it would normally be expected that the Fund would finance a substantial proportion of the adverse deviation. Every effort would be made to obtain parallel contingent financing from other creditors and contingency mechanisms would not be activated unless the program continued to be adequately financed. The proportion of the deviation to be financed could be changed at the request of the member at the time of the activation of the contingency mechanism, if the program was being affected by shocks of a nature that made the originally decided split between financing and adjustment inappropriate.

7. Phasing

Contingent financing would be phased through the baseline period at the same time as purchases under the associated arrangement. The phasing would take into account the timepath of the net deviation from the baseline and the timing of the implementation of additional policy measures. When a shock covered by the contingency variables had occurred the first purchase would be made available when the cumulative deviation from the baseline was projected to exceed the threshold. Subsequent purchases would be proportional to the net deviation estimated for the corresponding quarters, on the basis of shocks that had already been observed. When a member has made a purchase under a contingency mechanism on the basis of an estimated deviation which later is shown to be incorrect, the member will be expected, unless the Fund decides otherwise, to make a prompt repurchase to reverse any overcompensation.

8. Symmetry

When a favorable deviation relative to the baseline occurs, a substantial part of the favorable deviation would be used to build up reserves in cases where reserves were low. Where reserves were at a more adequate level, part of the favorable deviation would be reflected in a reduction of purchases under the basic arrangement, or, if an earlier contingency purchase had been made, the member could opt to repurchase contingency purchases.

9. Eligibility of SAF and ESAF arrangements for contingency mechanisms

It has been agreed that it would be desirable to permit contingency mechanisms to be attached to SAF and ESAF arrangements. In view of the limited amount of resources available to the Special Disbursement Account and the ESAF Trust and the restrictions on their utilization, financing for this purpose would need to be provided from the Fund's general resources. The possibility of providing for concessionality in the resources disbursed under contingency mechanisms for low-income countries will be reviewed at a later date.

The use of the Fund's general resources for contingency financing for SAF and ESAF arrangements raises issues with respect to the uniformity of treatment of Fund members. For this fundamental principle to be maintained, the conditionality attached to the use of the Fund's general resources under a contingency mechanism must be the same, whether this is in connection with a SAF arrangement, an ESAF arrangement, or an upper credit tranche arrangement.

This does not pose difficulties with respect to the ESAF, but to enable a contingency mechanism to be activated for a SAF arrangement, it would be necessary for the member concerned to agree to a program sufficiently strong to permit the Executive Board to determine that the SAF arrangement in question entailed conditionality equivalent to that of an upper credit tranche arrangement. It would also, as a practical matter, be necessary for such SAF arrangements (and, as relevant, for ESAF arrangements) to incorporate stronger provisions for monitoring, including a review to change benchmarks as necessary and to formulate them in a way that would govern the phased disbursements under the contingency mechanism, as well as to activate the mechanism.

The principle of uniformity precludes a differentiated overall ceiling on access to the Fund's general resources. Therefore, care will be taken to ensure that a SAF/ESAF-eligible member would not, by virtue of its eligibility both for arrangements under those facilities and for upper credit tranche arrangements, have higher access to the Fund's general resources under the contingency mechanism than a member who is not eligible for the SAF and ESAF.

10. Eligibility of enhanced surveillance procedures for contingency mechanisms

The attachment of contingency mechanisms to the procedures for enhanced surveillance would be examined further in the context of the review of enhanced surveillance.

11. Coverage

As a general principle, contingency mechanisms would cover unanticipated changes in the exogenous components of a few key external variables: export earnings, import prices, and interest rates. Other current account transactions (such as tourist receipts and migrant workers' remittances) could also be covered where they are of particular importance. Capital movements and unanticipated shifts in the volume of imports of goods and services would not be covered. Natural disasters would not be covered by contingency mechanisms, but could give rise to assistance under the Fund's decision on emergency assistance related to natural disasters.

Coverage in the context of a particular Fund arrangement would be determined on a case-by-case basis, in discussion with the authorities. In all cases, the specific set of variables selected would need to cover a substantial proportion of the exogenous components of the country's current account. At the same time, the authorities and the staff would have sufficient flexibility in determining coverage to avoid complications in the calculations of baselines and contingencies that could substantially delay agreement on programs and activation of the contingency mechanism. The subset of variables covered would be specified at the inception of the program and would remain unchanged throughout the life of the associated arrangement.

Contingency mechanisms would cover unforeseen changes in nominal interest rates, and would be limited to changes in benchmark international interest rates (such as LIBOR). Accordingly, unexpected deviations in interest costs stemming from changes in the risk premium, exchange rates, and unanticipated external borrowing would not be covered. Fund financing of interest rate contingencies would apply to the member's net external debt, which would generally be defined as the public and publicly guaranteed gross external debt minus official external assets. Such contingencies would apply only to instruments that are affected by unforeseen changes in interest rates.

Contingent financing of interest costs would be subject to a cumulative sublimit of 35 percent of quota. When such a limitation applied, the calculation of the net aggregate contingent deviation would be modified so as to avoid triggering the symmetric provisions of the mechanism in situations where the country would otherwise have experienced a contingent shortfall. Parallel contingent financing from commercial banks will be pursued vigorously. However, provided that adequate financing of the program is assured, there would not be a formal requirement for advance coverage of interest rates and other contingencies by mechanisms established with commercial banks. Countries also would be encouraged to hedge a part of their foreign debt against unforeseen rises in world interest rates, on the basis of the several instruments available in world financial markets.

12. Calculation of contingent deviations

Contingent deviations for individual current account variables would be calculated in relation to a baseline projection specified at the inception of the program. The aggregate size of the contingent deviation for a particular member would then be calculated as the net sum of deviations from baseline values for individual variables.

In preparing the baseline projections the staff would draw on World Economic Outlook forecasts of key variables, supplemented as appropriate by country-specific variables, and taking into consideration the country's circumstances. The key WEO projections would be updated as necessary to provide an adequate basis for the calculations. The baseline normally would be specified for a period of 12 months, and in any case no longer than 18 months. EFF and ESAF (and where appropriate SAF) arrangements would call for specification of annual baselines at the beginning of each program year.

In calculating the contingent deviations, the staff will adhere to the principle of exogeneity. Application of this principle would be straightforward for most import prices and export prices of key internationally-traded commodities. For countries with a diversified export base (typically including a substantial proportion of manufactures), the staff will estimate the impact of unforeseen changes in external demand on export earnings. As regards interest rates, the contingent deviation would be calculated by multiplying the stock of net external debt specified in the baseline by the unexpected deviation in the nominal LIBOR (or the appropriate benchmark rate where liabilities are denominated in currencies other than the U.S. dollar). When necessary, the calculation of contingencies would take into account information (particularly with respect to longer-term contracts) about the lags with which changes in world prices and international interest rates have an effect on the member's current account.

13. Compensatory financing element

In situations where the member's record of cooperation in recent periods had been unsatisfactory, or where its policies were seriously deficient, the compensatory financing element is to be made available in two tranches of equal size (each 20 percent of quota), given reasonable assurance that policies corrective of the member's balance of payments problems would be adopted.

14. Approval in principle

When compensatory financing requests are accompanied by Fund arrangements approved in principle, purchase of the full compensatory financing element (40 percent of quota) would be allowed for members with a good record of cooperation, and purchase of the first tranche (20 percent of quota) of the compensatory financing element would be allowed for other members.

15. Cereal decision

Overall access under the cereal decision and the compensatory and contingency financing facility will be 122 percent of quota, as set out under alternative A in the Annex to EBS/88/100. Symmetry with the agreement to maintain access at its current level of 83 percent of quota for export shortfalls for members with a satisfactory balance of payments position except for the effects of the export shortfall would suggest leaving in place the existing access limit of 83 percent of quota for cereal excesses and the existing joint limit of 105 percent of quota for members with a satisfactory balance of payments position except for the effects of the cereal excess/export shortfall. This approach implies a potential to include access for contingency financing up to an overall access limit of 122 percent of quota.

16. Transitional arrangements

Under transitional arrangements, (i) there would be access of 40 percent of quota for contingency financing for countries with outstanding CF purchases of more than 65 percent of quota at the time the new decision is approved; and (ii) CF requests on which discussions were initiated before the approval of the new decision would be governed by the current CF decision for a period of three months after the approval of the new decision.

17. Calculation of compensable export shortfalls

a. Projection limits

There would be an upper limit on the projections of export earnings to be used in the calculations of export shortfalls. The limit on the projected growth of the average level of exports in the two post-shortfall years over the average level of exports in the two pre-shortfall years would be set at 20 percent. Periodically, this limit would be reviewed, and if necessary revised, in the light of developments with respect to world inflation.

b. Adjustment for overcompensation and undercompensation

A compensatory financing request based on a shortfall falling within or overlapping with the two-year projection period of an earlier purchase would be adjusted by the amount by which the earlier purchase may have been overcompensated. Similarly, any undercompensation of the first purchase would be added to the subsequent shortfall when determining the size of the second purchase.

18. Avoidance of double compensation in compensatory and contingency financing

In calculating compensable amounts under the new facility, the staff will apply procedures to avoid double compensation between compensatory, including with respect to cereal costs, and contingency financing along the lines outlined in EBS/88/100. Under the procedures, a member with a contingency mechanism that includes export earnings as a variable should be able to be compensated under both contingency and compensatory financing, provided the amounts compensated under one component are deducted from the amounts to be compensated under the other. The member will have the choice to classify the amount of compensation deemed common to both contingency and compensatory financing as a purchase under either component.

Attachment

April 7, 1988 - 88/68
Final Version

The Chairman's Informal Remarks on the Compensatory Financing Facility and External Contingency Mechanisms

I would intend that these informal remarks be provided to the members of the Interim Committee as background. Our recent discussions lead me to believe that there is broad agreement in the following areas:

(1) On general principles, we have agreed that the essential features of the CFF should be preserved; that contingent Fund financing could help maintain the momentum of adjustment programs against adverse external shocks; and that the basic features of contingency mechanisms should include an appropriate blend of adjustment and financing, symmetry, and a focus on disturbances above a minimum threshold level involving external factors beyond the control of authorities.

(2) On the operational framework, there has been broad support for an approach that would combine CFF and ECM elements into a single facility, attaching the ECM element to Fund-supported adjustment programs. On overall access, agreement might be found on a figure of 105 percent of quota. The amount available under CFF and ECM elements would each be 40 percent of quota and an optional tranche to supplement either element at the choice of the member would be 25 percent of quota.

(3) On the CFF, the guidelines on cooperation approved by the Executive Board in 1983 would continue to apply to CF purchases. In applying the guidelines it would be the intention to ensure that purchases under the CFF continue to provide timely compensation for export shortfalls while at the same time providing reasonable assurance of protection of the Fund's resources. The application of the guidelines which would govern access to the CFF is set out in the Appendix. If a member decided also to apply the optional tranche to the CFF then that tranche would become available upon either approval or review of a program supported by the use of Fund resources or, in the absence of such a program, upon the Fund being satisfied that equivalent requirements had been met. It should be understood that where a member has a satisfactory balance of payments position except for the effect of the export shortfall, the member would continue to qualify for an outright purchase of 83 percent of quota.

(4) On the question of access to contingency financing, provision for such financing in a Fund arrangement would create a positive presumption of contingent financing for specified amounts which would be established on a case-by-case basis, taking into account the need for an appropriate mix of adjustment and financing and the member's capacity to meet its obligations to the Fund, and would not generally exceed 70 percent of the access under the associated basic arrangement.

After it appeared that a specified contingency was arising, a review by the staff would be carried out and Executive Directors would be asked to decide whether an ECM purchase was justified, the amount that was justified, the extent to which existing performance criteria might need to be modified, and the understandings that might need to be reached with the authorities on adaptation of policies. Such reviews would normally be conducted within the context of a mid-term program review, although in some cases it might be useful and appropriate to conduct an ad hoc review in order to expedite the process. In some exceptional cases, an attempt would be made to specify at the outset of the program the link between additional financing needs and the relevant contigencies and the policy actions that would need to be phased in should the contingencies arise. Where this specification could be done with sufficient precision, disbursement of contingent financing could proceed once it had been ascertained that performance criteria had been observed for the relevant period of the arrangement. In such cases, the staff assessment could be expedited and, after the Board had been informed, disbursements would be made. In all cases, disbursements would of course require observance of relevant performance criteria.

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There are still a number of important matters that remain to be discussed, including the mechanism for symmetry and the extent and nature of coverage for interest rate developments.

It would be my intention after the Interim Committee meeting to ask the Executive Board to consider further the modalities and operational elements of ECMs.

Attachment

Application of the Guidelines on Cooperation for the CFF

I would like to elaborate on my comments on how the guidelines on the test of cooperation would relate to the CFF, based on evolving experience. As I said, there would be no need for a change in the letter of the guidelines but we would need to interpret them in a manner that both ensures timely access for the member and provides an adequate degree of protection for the Fund's resources.

Except as provided for below, a request by a member experiencing balance of payments difficulties that go beyond the export shortfall would be presumed to satisfy the guidelines and a drawing for the full amount of the CFF element would be available immediately if the export shortfall were temporary, largely attributable to circumstances beyond the member's control, and the member was willing to cooperate with the Fund in an effort to find an appropriate solution to its balance of payments problems. The optional tranche would become available, as appropriate, in accordance with paragraph (3) of the main text.

On the other hand, if there were substantial indications that the member's record of cooperation in recent periods had been unsatisfactory, or that its existing policies were seriously deficient in relation to the size of its existing or prospective payments imbalances, then, consistent with the guidelines, we would continue to expect prior actions that would provide "reasonable assurance" that policies corrective of the member's balance of payments problems would be adopted. In these circumstances access to the CFF element would be in two tranches. The first would be disbursed as soon as appropriate prior actions are taken. Disbursement of the second tranche would take place according to the present guidelines and practices relating to the upper CF tranche. It would generally be expected that in these cases the optional tranche would become available upon program review.

It will be important in all cases to pay due attention to the member's capacity to service its debt obligations to the Fund.