FOR AGENDA

EBS/91/108

CONFIDENTIAL

July 3, 1991

To: Members of the Executive Board

From: The Secretary

Subject: Selected Operational Issues Related to the Use of Fund Resources

Attached for consideration by the Executive Directors is a paper on selected operational issues related to the use of Fund resources. This paper, together with two accompanying papers on selected aspects of conditionality (EBS/91/101, 6/20/91) and public expenditure management processes and fiscal conditionality (SM/91/136, 7/5/91), is tentatively scheduled for discussion on Friday, July 19, 1991. Summary and concluding remarks appear on pages 27-29.

Ms. Eken (ext. 6734) is available to answer technical or factual questions relating to this paper or Mr. Zavoico (ext. 7626) on questions relating to Section V prior to the Board decision.

Att: (1)

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

Selected Operational Issues Related to the Use of Fund Resources

Prepared by the Exchange and Trade Relations Department

(In consultation with other departments)

Approved by Jack Boorman

July 1, 1991

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I. Introduction

As specifically requested by Executive Directors for consideration as part of the 1991 conditionality review, this paper discusses issues related to conditionality on the use of Fund resources in the first credit tranche, contingency mechanisms outside the context of the compensatory and contingency financing facility (CCFF) and the prolonged use of Fund resources. The paper also reviews the provisions of the extended Fund facility (EFF), called for by the decision taken at the time of the 1989 conditionality review.

The plan of the paper is as follows: Section II outlines the evolution of Fund policies regarding the first credit tranche and reviews the conditionality associated with programs supported by first credit tranche transactions in the period 1980-89. The summary and concluding remarks are presented on pages 27-29. Section III reviews the provisions of the extended Fund facility in light of the experience since the changes to the provisions of the EFF in 1988. Areas where the staff is of the view that there is a need to clarify policy are indicated on pages 32-34. Section IV reviews the experience with contingency mechanisms covering current and capital account transactions that have been built directly into Fund arrangements. Issues that arise in the implementation of such mechanisms are discussed on pages 41-43. Section V reviews the developments with respect to prolonged use since the last comprehensive review of the subject in 1986 and considers issues related to the policy on the use of Fund resources by prolonged users. Conclusions are presented on pages 61-62.

II. Conditionality on the Use of Fund Resources in the First Credit Tranche

1. Introduction

Fund policy with respect to use of its resources in the first credit tranche was last discussed by the Executive Board in 1968 in the context of a general review of Fund policy with respect to the use of its resources and stand-by arrangements. 1/ Since then, although conditionality in upper credit tranche stand-by and extended arrangements has been reviewed on a number of occasions, the conditionality associated with Fund resources within the first credit tranche has not.

The Fund distinguishes between first and upper credit tranche conditionality in applying certain of its policies. For example, under the CCFF decision, access to compensatory financing beyond certain levels is

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1/ The review was based on "Fund Policy with Respect to the Use of Its Resources and Stand-by Arrangements," (SM/68/128, 7/23/68, and Supplements 1-4). For the conclusion of the review see Executive Board Decision No. 2603-(68/132), September 20, 1968.

conditioned on a member having a Fund arrangement in support of a program "... that meets the criteria for the use of the Fund's general resources in the upper credit tranches." 1/ Other creditors also differentiate between first and upper credit tranche conditionality, with official creditors (e.g., in the context of the Paris Club) generally requiring an upper credit tranche arrangement as a basis for restructuring official debt, and commercial bank creditors linking debt restructuring and new money packages to the existence of an upper credit tranche arrangement with the member.

During the past year, the question of the conditionality associated with use of Fund resources in the first and upper credit tranches has been raised on various occasions in the Executive Board, and Executive Directors requested a review of policies and experience with the use of Fund resources in the first credit tranche in the context of the 1991 conditionality review. This section attempts to address that request. Subsection 2 outlines the evolution of Fund policies regarding the first credit tranche and notes certain provisions that distinguish between the first and the upper credit tranches. Subsection 3 reviews the programs supported by first credit tranche transactions in the 1980s and assesses the conditionality associated with those programs. Subsection 4 provides a summary and concluding remarks.

2. Policy on the use of Fund resources in the first credit tranche

a. Pre-1968

In the early years of the Fund, before practical criteria for the use of the Fund's resources had been developed, members faced substantial uncertainty regarding the Fund's receptivity to requests for use of its resources, and only a limited number of requests were made. In 1952, the Fund adopted its first major decision setting out the circumstances under which members could make purchases. The decision clarified that access should not be denied because a member was in difficulty, that the task of the Fund is to help members that need temporary help, and that requests should be expected from members with strains in their external position of greater or lesser degree. In general, it stated that the Fund's attitude toward the position of each member should depend on whether the problem to be met is of a temporary nature and whether the policies the member will

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1/ See for example paragraph 12 of the CCFF decision, "Full Text of the Decision Establishing the Compensatory and Contingency Financing Facility" SM/90/228, 12/14/90.

pursue will be adequate to overcome the problem within such a period; the policies, above all, should determine the Fund's attitude. 1/

More specifically, the decision indicated that in light of the need to ensure the revolving character of the Fund's resources, exchange purchased from the Fund should not remain outstanding beyond the period reasonably related to the payments problem for which it was purchased from the Fund (it was then specified that the period should fall within an outside range of three to five years); and that members would be expected not to request purchases from the Fund in circumstances where the reduction of the Fund's holdings of their currencies by an equivalent amount within that time could not reasonably be envisaged.

The 1952 decision also set out the policy toward use of Fund resources in the gold tranche; the general policy toward use of Fund resources in the first and upper credit tranches was developed further in 1955 and 1957, respectively. In light of the Fund's various policy pronouncements and the development of the concept of the stand-by arrangement, the Fund's tranche policy was subsequently summarized as follows:

> "Members are given the overwhelming benefit of the doubt in relation to requests for transactions within the 'gold tranche', i.e., the portion of the quota which can be regarded as equivalent to the gold subscription. The Fund's attitude to requests for transactions within the 'first credit tranche,' that is, transactions which bring the Fund's holdings of a member's currency above 100 percent but not above 125 percent of its quota, is a liberal one, provided that the member itself is making reasonable efforts to solve its problems. Requests for transactions beyond these limits require substantial justification. They are likely to be favorably received when the drawings or stand-by arrangements are intended to support a sound program aimed at establishing or maintaining the enduring

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1/ "Use of Fund's Resources and Repurchases", Decision No. 102-(52/11), adopted February 13, 1952, reproduced in full in the International Monetary Fund, The International Monetary Fund 1945-65, Volume III, pp. 228-230. The development of the Fund's policy on the use of its resources is discussed in detail in "Fund Policy with Respect to the Use of Its Resources," SM/68/128, op cit.

That the Fund must make its resources available under "adequate safeguards" has been required under the Articles from the outset (Article I, Section (v)), and the principle that the use of the Fund's resources is to be temporary was clarified through an interpretation by the Executive Board on September 26, 1946. Terminology explicitly requiring "adequate safeguards for the temporary use" of the Fund's resources was introduced into the Articles through the First Amendment in 1969 (Article V, Section 3 (c)) and is in Article V, Section 3 (a) of the present Articles. Similar language appears also in Article I, Section (v).

stability of the member's currency at a realistic rate of exchange." 1/

This broad statement of policy left the distinction between the policy content of first and upper credit tranche arrangements open to the interpretation of the Fund as to what would constitute "reasonable efforts" on the one hand and "substantial justification" on the other. However, it is clear from the passages cited above that the policy content of both "reasonable efforts" and "substantial justification" needs to be seen in light of the economic circumstances of the member and the size and pace of adjustment that would be regarded as sufficient to establish adequate safeguards for the temporary use of the Fund's resources.

In the circumstances of generally limited alternative sources of balance of payments financing that prevailed at the time, it could reasonably be expected that a member whose need for Fund resources was limited to the first credit tranche would be addressing its balance of payments problems at an early stage, when it had sufficient reserves to meet its financing needs without large scale recourse to the Fund or before external imbalances had become serious or entrenched. In such circumstances, relatively modest policy adjustments could be seen as constituting a reasonable effort to overcome nascent or modest balance of payments problems. Moreover, given the structure of the Fund at that time, a member seeking use of resources in the first credit tranche would have no Fund credit outstanding other than possible credit from earlier first credit tranche purchases.

In contrast, a member facing serious financial imbalances would more likely request purchases extending into the upper credit tranches, where access to Fund resources would be larger. However, if in such circumstances a member limited its request to a first credit tranche request, its policy response would nonetheless need to be judged by the Fund as sufficient to establish adequate safeguards for the temporary use of the Fund's resources, as required by the Articles and given greater precision in the 1952 decision on the use of Fund resources.

1/ Annual Report 1959, page. 22.

b. The 1968 review

Fund policy with respect to the first credit tranche was reviewed in 1968, in the context of a more general review of policy on the use of Fund resources. The staff paper for the review reported that about half of the requests for assistance within the first credit tranche had been in the form of immediate purchases and about half in the form of arrangements; that where adjustments in policy had been called for, policy action had been taken before the requests in the majority of cases; that where such initial adjustments were judged adequate by the Fund to cope with the member's difficulties, stand-by arrangements had not involved performance criteria or phasing with respect to purchases in the first credit tranche; and that where immediate implementation of appropriate adjustment policies was not possible, arrangements had generally involved phasing to provide assurances that policy intentions were being implemented as planned. 1/

The paper also noted, however, that since the end of 1966, performance clauses had not been included in stand-by arrangements limited to the first credit tranche, even where there was strong evidence that payments problems had arisen from serious weaknesses in policy. This recent practice of omitting performance clauses in such circumstances was intended to distinguish more clearly the treatment accorded to use of the first credit tranche from that accorded to use of the higher credit tranches. Despite the absence of performance clauses, however, programs of action had been drawn in specific terms and the phasing of purchases in the first credit tranche (tied to consultations with the member) had generally continued. 2/

In the 1968 review, the staff proposed that the Fund decide as a general policy that performance clauses would not be used in stand-by arrangements that do not go beyond the first credit tranche; however, in cases where necessary policy adjustments could not be made immediately, it was proposed that phasing be retained and that a consultation clause provide for consultations in the event that policy declarations described in the program were not observed. The retention of these procedures was seen as having important implications for ensuring that measures would be adopted as planned, thus strengthening the assurances regarding the safeguards for the use of the Fund's resources.

In the discussion, a number of Executive Directors expressed the view that performance criteria and phasing of transactions within the first credit tranche would not be consistent with the principle of a liberal attitude toward operations in the first credit tranche. In the event, phasing in first credit tranche arrangements was eliminated in the conditionality guidelines adopted by the Executive Board in 1968. The

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1/ The phasing of purchases under Fund arrangements was first introduced in 1956 and by 1958 was included in the majority of stand-by arrangements.

2/ "Fund Policies with Respect to Use of Its Resources and Stand-By Arrangements," op. cit., page 16.

conditionality guidelines subsequently adopted in 1979 confirmed that phasing and performance clauses are to be omitted in stand-by arrangements that do not go beyond the first credit tranche, and this practice has been retained to date. 1/

Another distinction between the first and upper credit tranches relates to consultation clauses, which are incorporated in all stand-by arrangements. 2/ Consultation clauses in first credit tranche stand-by arrangements are limited, providing only for consultation during the period of the program, whereas such clauses in upper credit tranche arrangements provide for consultation during the whole period in which the member has outstanding purchases in the upper tranches. 3/

c. Other developments

A further relevant development has been the introduction of provisions for the "floating" of CFF and EFF purchases with respect to the first credit tranche. Prior to the introduction of these provisions, requests for use of Fund resources in the first credit tranche were necessarily associated with no Fund credit outstanding other than possible credit from first credit tranche purchases. The introduction of the Compensatory Financing Facility (CFF) in 1963 and the EFF in 1974, both on a "floating" basis, gave rise to the possibility that a member could have a high level of Fund credit outstanding at the time of a request for a first credit tranche purchase. This possibility has been increased by subsequent modifications of CFF access and the introduction of the enlarged access policy, which increased the availability of resources under stand-by and extended arrangements but left intact the floating character of purchases under extended arrangements. In a review of the enlarged access policy in 1980, the staff proposed the elimination of the floating nature of EFF purchases vis-à-vis the first

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1/ Selected Decisions and Selected Documents of the International Monetary Fund, Fifteenth Issue, page 55. Although phasing and performance clauses are included in all upper credit tranche stand-by arrangements, they are applied only to purchases beyond the first credit tranche.

2/ Paragraph 5 of the Conditionality Guidelines.

3/ Paragraph 2 of Executive Board Decision No. 2603-(68/132) adopted at the end of the 1968 review of conditionality states that "Provisions will be made for consultations, from time to time, with a member during the whole period in which the member is making use of the Fund's resources beyond the first credit tranche whether or not the use results from a stand-by arrangement."

credit tranche, but this change was not approved by the Executive Board. 1/

3. Experience in the 1980s with use of Fund resources in the first credit tranche

a. Overview

A member may use resources in the first credit tranche (as in the other tranches) either in the form of an outright purchase or under a stand-by arrangement. 2/ Whether the request is for an outright purchase or an arrangement, the member prepares a letter of intent which describes the adjustment program that is to be implemented. The letter, together with an accompanying staff paper which includes an appraisal of the policies described in the letter of intent, forms the basis for an assessment by the Fund that the member is making reasonable efforts to solve its problems and that there are adequate safeguards for the temporary use of the Fund's resources.

During 1980-89, the Fund approved 17 requests for 14 different members for transactions within the first credit tranche (Table 1). 3/ Of these requests, 12 were in the context of first credit tranche stand-by arrangements and 5 were in the form of outright purchases. Except for the 1980 arrangement for Uruguay, purchases were made under all of the first

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1/ The staff indicated that elimination of the floating character of extended arrangements above the first credit tranche would contribute to a simplification of procedures that gave rise to the oddity of affording the first credit tranche preferred status in comparison with the reserve tranche, i.e., that the first credit tranche could be preserved whereas the reserve tranche had to be used before entering into the upper credit tranches. See "Enlarged Access to Fund Resources," EBS/80/262, 12/4/80, page 11, and "The Chairman's Summing Up at the Conclusion of the Discussion on Enlarged Access to Fund Resources, EBM/80/188, 12/19/80," Buff 81/4, 1/9/81.

2/ With the elimination of phasing in first credit tranche arrangements in 1968, the main difference between an outright purchase and a stand-by arrangement in the first credit tranche is that the latter can provide more flexibility to a member, in that it may draw at any time during the period of the arrangement without further review by the Fund. Hence, a stand-by arrangement in the first credit tranche could be used as a second line of reserves rather than to meet immediate needs.

3/ In addition, during this period there were several purchases in the first credit tranche in the context of upper credit tranche stand-by arrangements; 9 first credit tranche purchases in the context of extended arrangements; and 10 purchases in connection with the Fund's policy on emergency assistance related to natural disasters.

Table 1. First Credit Tranche Stand-by Arrangements and Outright Purchases, 1980-89

Country	Date of Executive Board approval	Type of Transaction	Amount (in millions of SDRs)	Associated Compensatory Financing Purchases 1/	Preceded or Followed by other Fund Arrangements 2/
Uganda	1/4/1980	Arrangement	12.50	1/9/1980	SBA-F
Central African Republic	2/15/1980	Arrangement	4.00		SBA-P,F
Uruguay	5/14/1980	Arrangement (no purchase made)	21.00		SBA-P,F
El Salvador	6/23/1980	Arrangement	10.75		
Cyprus	7/16/1980	Arrangement	8.50		
Vietnam	1/8/1981	Purchase	28.40		
China	3/2/1981	Arrangement	450.00		
Western Samoa	4/6/1981	Purchase	0.75	4/9/1981	
Zimbabwe	4/8/1981	Arrangement	37.50		SBA-F
Uruguay	7/15/1981	Arrangement	31.50		SBA-P,F
Guatemala	11/13/1981	Arrangement	19.10	11/18/1981	SBA-F
Guinea-Bissau	8/27/1984	Purchase	1.88		
China	11/12/1986	Arrangement	597.73		
Venezuela	3/29/1989	Purchase	342.88		EA-F
Algeria	5/31/1989	Arrangement	155.70	6/5/1989	
Chile	9/20/1989 3/	Purchase	18.75		EA-P,SBA-F
Chile	11/8/1989	Arrangement	64.00		EA-P

Sources: Executive Board documents.

1/ Within the same program period.
2/ Stand-by (SBA) or extended arrangements (EA) within 12 months prior (P) and/or within 24 months following(F) the Executive Board approval of the first credit tranche transaction.
3/ Approved on a lapse of time basis.

credit tranche arrangements. 1/ All the arrangements were for a period of 12 months except the 1981 arrangement for China, which was for a 10 month period.

At the time of their requests for use of Fund resources in the first credit tranche, members had relatively low amounts of Fund exposure in all cases except that of Chile in 1989, where the use of resources in the first credit tranche followed substantial use of Fund resources under an extended arrangement. In 2 cases, first credit tranche arrangements or transactions were followed within 2 years by another first credit tranche transaction, in 5 cases by upper credit tranche stand-by arrangements, and in one case by an extended arrangement. Three members also made subsequent use of Fund resources, but after a more lengthy interval. Since the time of their most recent first credit tranche transactions to date, 6 members (Algeria, Chile, China, Cyprus, Vietnam and Zimbabwe) have not sought further Fund support. 2/

In all cases, requests for transactions in the first credit tranche were in support of programs developed in the context of a macroeconomic framework. The policy content of these programs, which often included structural reforms as well, varied widely. Moreover, there has been a change in the timeframe of programs. In the early-1980s, the programs were generally formulated and assessed within a one year timeframe. By the mid-1980s, programs were being formulated in a medium-term framework, and the appropriateness of adjustment efforts and the adequacy of policy measures were assessed in this context. The medium-term orientation and assessment of programs applied both to stand-by arrangements and to outright purchases in the first credit tranche.

b. Program objectives

The objectives of the programs supported by use of resources in the first credit tranche were in line with the general aims of programs supported by the Fund, that is, the correction of economic imbalances to lay the basis for achievement over the medium-term of a viable balance of payments position with price stability and sustainable growth.

As regards balance of payments objectives, which hinged importantly on the prospects for external financing, first credit tranche programs generally aimed at some improvement in the current account position and/or some buildup (or at least a reduction in the rate of decline) in

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1/ The full amount available under stand-by arrangements was purchased shortly after Executive Board approval of the arrangements, except in the case of the 1981 arrangement with Uruguay which was drawn close to the end of the period of the arrangement.

2/ Vietnam was declared ineligible to use Fund resources because of overdue obligations to the Fund in January 1985.

international reserves (Tables 2 and 3). A widening in the external current account deficit was targeted, for example, in cases where imports had recently been compressed, an improvement in the capital account was projected, a substantial deterioration in terms of trade was forecast, or exchange liberalization measures had recently been implemented. The external current account deficit was targeted to rise in 5 of the 15 programs which specified current account objectives (Uganda, El Salvador, Vietnam, Zimbabwe and Chile). In 2 other programs (Uruguay in 1980 and 1981), the targeted improvement in the external current account was less than 0.5 percent of GDP. 1/

The overall balance of payments deficit was also projected to widen in a few cases (the Central African Republic, Vietnam and China 1981), and the 1981 program for Uruguay provided for a decline in the overall surplus. In most countries where external payments arrears had been accumulated (Uganda, the Central African Republic and Guinea-Bissau), a decline or stabilization of their level was programmed. Exceptionally, in the case of Venezuela in 1989, the possibility of an increase in arrears was envisaged pending the negotiation of a debt restructuring agreement with foreign commercial bank creditors.

Programs supported by first credit tranche transactions typically focused on restoring macroeconomic balance and improving resource allocation to promote sustainable growth in output and employment over the following years. In the program year, the average growth rate was targeted to be over 4 percent, compared with growth averaging 2 percent in the pre-program year (Table 4). Growth was programmed to rise substantially in cases where economic activity had recently declined owing to a poor harvest, disruptions associated with political developments, or shortages of raw materials and supplies (Uganda, the Central African Republic, Vietnam, Western Samoa, Guinea-Bissau and Algeria). Cases where the growth rate was programmed to fall included countries that had grown relatively fast in the recent past or cases where the expected effects of adverse exogenous factors had been incorporated in the programs (Uruguay 1980, Venezuela and Chile).

Most programs targeted a decline in inflation (Table 5). However, in a number of cases the rate of price increase was programmed to rise compared to the pre-program period. In Guinea-Bissau, Venezuela and Algeria this

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1/ The extent to which programs provided for a widening in the external current account deficit (or an improvement of less than 0.5 percent of GDP) was broadly similar in the upper credit tranche and extended arrangements that are reviewed in the accompanying paper on upper credit tranche conditionality. In 44 upper credit tranche and extended arrangement programs in effect in the period 1985-88, about one-third provided for an increase in the external current account deficit, and about 10 percent projected an improvement of less than 0.5 percent of GDP. See "Review of Selected Aspects of Conditionality Under Stand-by and Extended Arrangements."

Table 2. External Current Account: Program Objectives and Outturn

(In percent of GDP)

	Previous three years				Program year		Following Year
	-3	-2	-1 Estimate	-1 Actual	Object.	Outturn	
Uganda 1/	...	...	...	...	...	...	...
Central African Republic	-13.2	-15.0	-14.7	-13.4	-14.0	-19.2	-21.6
Uruguay (1980)	...	-2.7	-4.8	-4.6	-4.6	-6.1	-4.3
El Salvador 2/	1.0	-7.6	0.3	0.6	...	0.9	-7.1
Cyprus 3/	...	-8.8	-15.5	-15.0	-9.7	-7.9	...
Vietnam	...	-5.6	-4.2	-5.4	-4.7	-10.1 4/	-7.5
China (1981) 5/	...	...	...	-1.1	...	0.5	2.2
Western Samoa	-38.0	-33.0	-36.4	-29.9	-34.3	-27.2	-17.1
Zimbabwe	...	...	-3.0	-5.8	-5.0	-12.1	-12.2
Uruguay (1981)	-2.7	-4.6	-5.3	-6.1	-4.9	-4.3	-4.8
Guatemala	-2.8	-2.1	-6.0	-6.7	-4.6	-4.6	-2.8
Guinea-Bissau 6/	-13.3	-20.3	-16.4	-25.4	-16.8	-22.8	-28.7
7/	-26.3	-46.2	-44.4	-63.0	-42.2	-41.2	-46.9
China (1986) 8/	0.9	-4.5	-4.0	-2.6	-2.3	0.1	-1.0
Venezuela	-3.2	-2.6	-8.1	-10.7	-4.7	5.6	13.0
Algeria 9/	-3.6	0.2	-1.4	-4.5	-0.8	-2.5	2.0
Chile	-4.3	-0.8	-2.9	-3.1	-6.5	-2.7	...

Sources: Executive Board documents.

1/ Current account deficit was programmed to increase from SDR 14 million in 1979 to SDR 111 million in 1980; the outcome was a deficit of SDR 172 million. GDP data were not included in the staff report. Data in consultation reports are on a fiscal year basis.

2/ Ratios are derived. In the staff report, there was no estimate for GDP for the program year; the current account was projected to register a deficit of US$125 million compared to an estimated surplus of US$10.6 million in the pre-program year.

3/ Data on a program year basis not available in consultation reports.

4/ The percentage also reflects a decline in GDP expressed in U.S. dollars resulting from the 1981 devaluation. The current account deficit was US$996 million against the programmed US$775 million.

5/ Current account data in billions of U.S. dollars; GDP or national income data not presented in the staff report.

6/ Including official transfers.

7/ Excluding official transfers.

8/ Ratios to GNP.

9/ Ratios are derived.

Table 3. Overall Balance of Payments: Program Objectives and Outturn

(In millions of U.S. dollars; unless otherwise stated)

	Previous three years				Program year	
	-3	-2	-1 Estimate	-1 Actual	Object.	Outturn
Uganda 1/	20.0	-46.0	-2.0	-86.3	34.0	-153.4
Central African Republic 1/	0.7	-8.8	-4.3	7.7	-9.0	-0.4
Uruguay (1980)	124.9	163.5	62.6	63.0	185.0	181.0
El Salvador	20.8	13.0	-105.0	-101.0	-65.0	-325.4
Cyprus 2/	...	17.2	-46.0	-43.5	-18.0	-23.2
Vietnam	-52.0	19.0	6.0	15.0	-50.0	-241.0
China (1981) 3/	...	-0.8	0.7	0.4	-0.6	1.9
Western Samoa 1/	-5.7	-1.5	-2.7	-3.6	-2.5	-7.2
Zimbabwe 1/	127.8	48.9	-111.2	35.9	-14.5	-150.5
Uruguay (1981)	163.5	63.0	181.0	181.0	88.0	12.0
Guatemala	-27.0	-319.0	-280.0	-319.0	-50.0	-348.0
Guinea Bissau	-6.4	-20.0	-17.2	-17.3	0.3	-15.8
China (1986) 3/	1.8	-4.6	-1.9	-2.0	1.3	4.9
Venezuela 3/	-4.7	-0.7	-4.1	-4.8	-3.7	0.8
Algeria 3/	-1.5	-0.3	-0.8	-0.8	-0.4	-0.6
Chile	-982.0	-880.0	-500.0	420.0	-- 4/	2306.0

Sources: Executive Board documents.

1/ In millions of SDRs.
2/ In millions of Cyprus pounds.
3/ In billions of U.S. dollars.
4/ The adjusted target (the original program target increased by deposits in the Copper Stabilization Fund in excess of program, less reserves used in debt buyback) was US$725 million.

Table 4. Real Gross Domestic Product: Progam Objectives and Outturn
(Percentage change)

	Previous three years				Program year		Following
	-3	-2	-1 Estimate	-1 Actual	Object.	Outturn	Year
Uganda	...	...	-8.0	-8.0 1/	7.0	-3.2 1/	-5.8 1/
Central African Republic	5.7	2.3	0.0	-3.0	3.0	-3.9	-2.2
Uruguay (1980)	3.4	3.9	8.3	6.2	5.0	6.0	1.9
El Salvador	6.1	4.0	-1.5	-1.5	... 2/	-9.6	-9.5
Cyprus 3/	...	...	4.9	6.3	3.5	3.2	...
Vietnam	...	-0.5	-4.0	-3.7	3.0	5.1	8.2
China (1981) 4/	12.0	7.0	5.0	6.1	4-5	4.8	7.4
Western Samoa	-5.0	7.0	1.0	-6.1	4-5	-9.1	-1.0
Zimbabwe	...	...	8.0	11.3	8-10	12.2	1.9
Uruguay (1981)	3.9	8.6	4.5	6.0	4-5	1.9	-9.7
Guatemala	4.7	3.5	1.0	0.6	2.5	-3.5	-2.8
Guinea Bissau	18.0	4.2	-5.1	-3.4	5.9	5.5	4.3
China (1986) 5/	13.5	12.3	6.5	8.3	6.0	11.0	10.8
Venezuela	6.8	3.0	4.2	5.8	-0.3	-8.3	2.3
Algeria	1.0	-1.1	-1.8	-2.1	4.7	3.4	2.4
Chile	5.7	7.4	8.5	10.0	4.5	1.8	...

Sources: Executive Board documents.

1/ Averages of data on a fiscal year basis.
2/ Not explicitly mentioned in the staff report.
3/ Consultation reports are not on a program year basis.
4/ Real national income.
5/ Gross national product.

Table 5. Inflation: Progam Objectives and Outturn

(Percentage change)

	Previous three years				Program year		Following Year
	-3	-2	-1 Estimate	-1 Actual	Object	Outturn	
Uganda	...	...	60.0	60.0	25.0	125.0	...
Central African Republic	10.6	11.9	14.0	9.3	10.0	17.3	12.7
Uruguay (1980)	58.2	44.5	66.8	83.1	40.0	63.5	34.0
El Salvador	11.8	13.3	24.0	12.1	... 1/	17.4	14.7
Cyprus	...	...	15.0	...	... 2/	10.0	...
Vietnam 3/	...	...	...	...	...	...	...
China (1981) 4/	-2.8	1.7	5.3	6.0	--	2.4	2.1
Western Samoa	2.1	11.1	33.1	20.5	22.0	20.5	18.4
Zimbabwe	...	...	...	7.3	15.0	13.9	14.6
Uruguay (1981)	44.5	66.8	43.0	63.5	30-35	34.0	19.0
Guatemala	11.5	10.7	12.5 5/	11.4	... 6/	5.0	6.4
Guinea Bissau 7/	11.6	16.5	23.4	23.3	52.9	64.9	44.8
China (1986)	2.8	8.8	5.5	6.0	7.0	7.3	18.6
Venezuela	11.6	28.1	29.5	29.5	35.0	84.5	40.7
Algeria	12.3	7.5	5.9	5.9	10.0	9.3	16.0
Chile	19.9	14.7	15.2	21.4	14.0	27.8	...

Sources: Executive Board documents.

1/ Not explicitly indicated in the staff report.
2/ No quantitative target for inflation was set; the objective was to lay the foundation for a decline in the rate of inflation.
3/ Price indices were not available.
4/ Cost of living index.
5/ The cost of living increase based on the first six months of the year.
6/ Domestic prices (as measured by the GDP deflator) were projected to increase by 11 percent; the actual increase in the GDP deflator was about 6.5 percent.
7/ GDP deflator included in staff reports; price indices were not available.

rise reflected a relaxation of price controls, major adjustments in administered prices (of essential consumer goods, energy, and services) and increases in wages and salaries (following a period of declining real wages); in China 1986, a pickup in the rate of price increase reflected the expected effects of price reforms.

c. Policy content of programs

(1) Fiscal policy

Most adjustment programs supported by first credit tranche transactions included both demand management policies to correct underlying macroeconomic imbalances in the short-run and measures to strengthen the supply response of the economy and promote efficiency of investment and resource allocation over the longer term. A few programs involved a shift toward a more market-oriented approach to economic management.

Most programs targeted a substantial reduction in the fiscal deficit (Table 6). However, 6 of the 15 programs that specified fiscal objectives allowed for an increase in the fiscal deficit or a reduction in the fiscal surplus, or targeted a reduction in the deficit of less than 0.5 percent of GDP (Uruguay 1980, El Salvador, Zimbabwe, Uruguay 1981, China 1986 and Chile). 1/

Programs relied on both revenue and expenditure measures to contain fiscal deficits. Revenue measures included increases in existing income and sales tax rates (Uganda, the Central African Republic, Uruguay, Western Samoa, Zimbabwe, and Guinea-Bissau), import duties (Western Samoa and Zimbabwe), and service charges and fees (Western Samoa), as well as the introduction of new taxes (Uruguay, Cyprus and Zimbabwe). In addition, in the Central African Republic and Uruguay, tax exemptions and investment allowances were reduced or abolished.

Expenditure restraint measures included limits on wage and salary adjustments in the public sector (the Central African Republic, Western Samoa, Guatemala, and Chile), limits or reductions on subsidy payments (Vietnam, Zimbabwe and Venezuela), or the implementation of new expenditure control mechanisms (Uganda and Guinea-Bissau). Vietnam, Western Samoa, and

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1/ By way of comparison, in the 44 upper credit tranche and extended arrangement programs referred to above, only about 25 percent provided for a deterioration in the overall fiscal position or targeted an improvement of less than 0.5 percent of GDP. However, any comparison of fiscal effort based on targeted developments in the overall balance needs to be interpreted with considerable caution. For example, if a country is entering into a recession or experiencing a decline in its terms of trade (with adverse implications for tax receipts), a major fiscal effort might be associated with little improvement in the fiscal balance or even a rise in the overall fiscal deficit.

Table 6. Fiscal Adjustment: Progam Objectives and Outturn
(Budget deficit or surplus in percent of GDP)

		Previous three years				Program year		Following
		-3	-2	-1 Estimate	-1 Actual	Object.	Outturn	Year
Uganda 1/		...	...	...	45.0	...	63.0	...
Central African Republic		-4.2	-5.0	-2.3	-5.2	-0.8	-5.2	-3.2
Uruguay (1980)		-1.2	-0.6	0.7	0.7	0.1	-0.4	-0.9
El Salvador 2/		...	-1.4	-4.7	-2.2	-6.0	-7.3	-11.4
Cyprus 3/		...	-4.6	-4.4	...	-1.2	-2.9	...
Vietnam		-8.8	-10.4	-9.0	-9.8	-7.6	-9.8	-19.7
China (1981)		0.3	-4.5	-2.9	-3.5	-1.2 4/	-1.3	-1.4
Western Samoa 5/		-20.7	-15.7	-18.0	-14.2	-13.8	-14.6	-12.3
Zimbabwe		...	...	-13.1	-12.3	-12.8 6/	-9.3	-8.3
Uruguay (1981)		-0.6	0.7	0.1	-0.4	--	-0.9	-9.1
Guatemala		-2.6	-4.7	-6.4	-7.4	-4.2	-4.7	-3.6
Guinea Bissau		-27.3	-25.8	-22.3	-23.0	-17.3	-27.0	-27.9
China (1986) 7/		-1.6	-0.5	-0.4	-2.0	-0.3	-2.2	-2.5
Venezuela 8/	a.	-4.4	-5.3	-6.3	-7.4	-3.0	-1.3	1.2
	b.	-4.4	-3.5	-4.2	-4.9	1.0	0.7	3.6
Algeria 9/	a.	-4.5	-3.5	-5.0	-8.5	--	-2.2	3.6
	b.	-12.3	-7.5	-10.4	-14.5	-3.1	-2.3	3.5
Chile 10/	a.	-0.4	2.5	3.0	5.3	-0.1	2.7	...
	b.	-0.8	-0.9	-0.3	1.9	-0.4	0.1	...

Sources: Executive Board documents.

1/ The fiscal deficit as a proportion of expenditure was targeted to decline. GDP data not given. Data in consultation reports were on a fiscal year basis.
2/ Consolidated operations of the public sector.
3/ Under the new classification, the budget deficit was 6.3 percent of GDP in 1979/80, the program would have targeted a deficit of 2.9 percent of GDP and the actual deficit was 7 percent of GDP in 1980/81.
4/ The deficit was programmed to decline from Y12 billion to Y5.5 billion. The outturn was a deficit of Y5.8 billion, but as a percent of GDP the deficit declined by more than programmed.
5/ It is not clear whether the program target was on a cash or commitment basis. On a commitment basis deficits as a percentage of GDP were -14.3 in 1980, -16.2 in 1981 and -15.7 in 1982.
6/ The fiscal year ending in June 1981. In 1981/82 the deficit was targeted to decline to 11.4 percent of GDP.
7/ Ratios to GNP.
8/ Including (a) and excluding (b) exchange losses of the central bank.
9/ Budgetary surplus or deficit (a) and the overall deficit on treasury operations which includes movements in special accounts and net loans and net advances to public enterprises (b).
10/ The overall surplus/deficit including (a) and excluding (b) copper windfalls.

Algeria restrained both current and capital expenditures, while China 1981 and Guatemala relied mainly on a slowing or cutting of investment projects.

In a number of programs, efforts to raise taxes and reduce expenditures were accompanied by reforms in the areas of taxes and public enterprises. Tax reforms included changes in the social security system (Uruguay and Cyprus), a broadening of the coverage of the value added tax (Uruguay) and moves from specific to ad valorem taxes (Guinea-Bissau). Improvements in tax administration were undertaken (the Central African Republic, Uganda, Guatemala and Algeria) to increase yields and reduce tax evasion. The reform of public enterprises (the Central African Republic, Vietnam, Guinea-Bissau, China 1986 and Algeria) involved more flexible pricing policies and changes in the managerial structure.

(2) Credit and interest rate policies

Credit policies were generally an important element of demand restraint and most programs targeted a slowdown in the expansion of domestic credit (Table 7). Generally, the slowdown in credit expansion was to be based on a reduction in the rate of growth of credit to the public sector. An exception was the case of El Salvador, where virtually all of the overall expansion in credit was accounted for by increased borrowing of the public sector to finance social reforms; credit expansion to the private sector was limited in an effort to induce coffee exporters to surrender exportable production and to reduce capital flight.

A number of programs incorporated increases in deposit and lending rates (Vietnam, Western Samoa, Zimbabwe, Guatemala, Guinea-Bissau, China 1986 and Algeria) or the elimination of controls on most interest rates (Venezuela). 1/ Among other cases, interest rates in Uruguay and Chile were already freely determined. To increase the effectiveness of monetary policies, some programs also included improvements in and more flexible use of indirect monetary instruments and control techniques, such as open market operations and rediscount rates in Venezuela and Algeria, and adjustments to the rediscount rate in China 1986.

(3) Pricing and exchange rate policies

Pricing policies, relating to producer, consumer and input prices, were also important elements of programs in a number of countries (Uganda, the Central African Republic, Vietnam, Zimbabwe, Guinea-Bissau, China 1986 and Venezuela). These measures aimed at a more efficient allocation of resources in association with exchange rate adjustments and to improve the fiscal position. In Cyprus, Vietnam, Western Samoa, Guinea-Bissau and Venezuela, price adjustments included increases in domestic petroleum

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1/ In the case of Guinea-Bissau interest rates on bank deposits were established for the first time.

Table 7. Credit Policy: Program Objectives and Outturn

(Percentage Change)

	Pre-program Year	Objective	Outturn
Uganda	-9.3	19.3	34.7
C.A.R.	27.0	18.0	53.0
Uruguay (1980) 1/	48.7	-7.6	1.0
El Salvador 2/	93.3	29.9	56.5
Cyprus	26.0	16.0	16.3
Vietnam	15.5	10.4	140.0 3/
China (1981)	...	TNS	...
Western Samoa	37.2	32.3	35.8
Zimbabwe	29.8	50.0	-10.2
Uruguay (1981) 1/	1.0	21.6	15.2
Guatemala	40.8	20.3	18.6
Guinea-Bissau	49.0	38.4	54.5
China (1986)			
Central Bank	27.1	12.8	13.1
Banking system	34.0	13.6	21.7
Venezuela 1/	254.6	13.8	58.7
Algeria	12.3	8.8	7.2
Chile	-259.9	11.7	-416.9

Sources: Executive Board documents.

1/ Change in net domestic assets of the Central Bank as a percent of beginning of period currency issue.

2/ Change in net domesic assets of the Central Bank as a percent of beginning of period currency issue. Targets were set for end-December 1980 while outturn reported for September 1980.

3/ Targets were set for end-September 1981 while outturn reported for December 1981.

prices. In Vietnam, Guinea-Bissau, China 1986, Venezuela and Algeria, price flexibility was a key feature of adjustment programs where streamlined price control systems were introduced, the scope of price controls was reduced, and steps were taken to increase links between domestic and international prices. China's 1981 program, on the other hand, included stricter controls over prices to supplement the dampening effect of reduced monetary expansion on inflation.

Exchange rate adjustments were a feature of many programs. In a few cases (Vietnam and China 1986), exchange rate policy was accompanied by other incentives to promote exports. 1/ Policy actions took various forms. Sizeable exchange rate adjustments took place at the beginning of the programs in Vietnam, Guinea-Bissau and China 1986. In Uruguay, the policy of preannounced depreciations, which was an important tool of the authorities' anti-inflationary strategy, was continued. In Algeria and Chile the exchange rate was to be adjusted in line with certain indicators. 2/ In Venezuela, a highly complex and distorted structure of exchange rates was replaced by a new, unified exchange rate regime, with the rate to be determined by market forces. In addition, exchange rate guarantees with respect to new debt and trade transactions were discontinued with the development of a forward exchange market.

Among programs that did not include exchange rate policy measures at the beginning of the adjustment effort, an exchange rate action was programmed during the first half of the program period in Uganda. In Zimbabwe, no specific exchange rate action was indicated, but the authorities undertook to review the appropriateness of the exchange rate semiannually.

(4) Other

In a number of cases, steps were taken toward the liberalization of the exchange and trade system. Reforms of trade systems were most

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1/ For example, exporters in Vietnam were given bonuses and benefitted from increased access to credits in foreign exchange and incentives in the form of rights to import machinery, raw materials, or needed consumer goods in proportion to the export performance in excess of plan targets. In China, enterprises engaged in foreign trade were given greater flexibility in setting prices and the number of items which enterprises could import and export directly was increased.

2/ In Algeria, the exchange rate policy of the previous two years, involving a smooth depreciation of the dinar against a basket of currencies, was continued with a view to eliminating the spread between the official and parallel exchange rates within three years. In Chile, the peso was devalued daily on the basis of the difference between domestic inflation in the previous month and the external rate of inflation relevant for Chile.

comprehensive in Uruguay, Venezuela and Algeria. 1/ In Zimbabwe, the program followed a liberalization of the exchange system which allowed the repatriation abroad of profits and dividends. In El Salvador and Guatemala, programs had been preceded by a major intensification of exchange and trade restrictions to contain imports and curb capital flight, but the authorities made the standard commitment included in all programs supported by first credit tranche transactions not to intensify existing or introduce new restrictions during the program period. A reduction in external payments arrears was programmed in Uganda, the Central African Republic and Guinea-Bissau.

The focus of attention on external debt issues increased in programs following the mid-1980s. Besides indicative limits on the contracting and guaranteeing of nonconcessional external borrowings, policies to address debt issues included efforts to strengthen debt management through improvements in approval and monitoring procedures (China in 1986); to consolidate and/or renegotiate external debt (Guinea-Bissau); to restructure debt repayments to commercial banks (Venezuela); and to reduce debt owed to commercial banks (Chile and Venezuela).

d. Program monitoring

All requests for transactions in the first credit tranche were accompanied by letters of intent describing the policies that were being implemented and that the member intended to pursue to achieve the objectives of the program. 2/ In nearly all of the programs supported by first credit tranche transactions, some measures considered necessary for the effectiveness of the program were adopted before the request for the transaction was approved by the Executive Board. In many cases, important policy measures to be implemented subsequently during the program period represented further steps in the reform process or initiatives that were delayed, either because of budgetary cycles or the need to proceed first with changes in the institutional structure.

The nature of policy actions adopted before the approval of the use of Fund resources varied from case to case. A large number of programs incorporated concrete measures to raise government revenue either in the

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1/ The elimination of the remaining multiple currency practice also allowed Uruguay to assume Article VIII status.

2/ Except in the case of Chile's purchase in the first credit tranche in September 1989, for which a staff memorandum on the request for a first credit tranche purchase was circulated to the Executive Board. "Chile - Request for a Purchase in the First Credit Tranche" (EBS/89/185, 9/14/89). In this instance, the final purchase that had been envisaged to take place under the extended arrangement was in effect made in the first credit tranche, because the data for assessing compliance with performance criteria and the purchase request under the extended arrangement were received after the expiration date of the arrangement.

form of increases in tax rates and/or the introduction of new taxes (Uganda, the Central African Republic, Uruguay 1980, Cyprus, Vietnam, Western Samoa, Uruguay 1981, Guatemala and Guinea-Bissau). Restraints on public expenditures included cuts in subsidies and capital expenditures, and freezes on wages and salaries in the public sector (the Central African Republic, China 1981, Western Samoa and Zimbabwe).

In a number of programs that included interest rate adjustments or the elimination of controls on interest rates, such measures were implemented before the use of Fund resources was approved (Vietnam, Western Samoa, Zimbabwe, Guatemala, Guinea-Bissau, China 1986, Venezuela and Algeria). Adjustments to producer prices for cash crops and to administered prices of consumer goods and public utilities, as well as changes in price control and rationing systems, were similarly implemented before approval of arrangements or purchases (Uganda, Cyprus, Vietnam, Western Samoa, Guinea-Bissau and Venezuela).

Substantial currency depreciations in Vietnam, Guinea-Bissau, China 1986, and Chile, and the move to a market-determined exchange rate in Venezuela, also took place before approval of the use of Fund resources. A number of programs (Uruguay 1980, Zimbabwe, Uruguay 1981, Venezuela, and Algeria) were preceded by a liberalization of the exchange and trade system and Fund support was considered essential for the success of the members' efforts in this regard.

Quarterly indicative targets were specified in 8 of the programs supported by first credit tranche stand-by arrangements and in one of the programs supported by an outright purchase (Table 8). The quarterly targets were similar in coverage to the performance criteria used to monitor developments under upper credit tranche arrangements. All programs with such quarterly targets had them either on net domestic assets of the banking system or of the central bank, in about half of the cases with a subceiling on net credit to government. In 5 programs, quarterly targets were also set on the overall balance of the central government or the nonfinancial public sector. Benchmarks on external debt included limits on the contracting or guaranteeing of nonconcessional debt by the government, ranging in maturities of 1 to 15 years and on the stock of short-term debt.

Consultation clauses were included in all requests for transactions in the first credit tranche, either in the letter of intent (in the case of outright purchases) or in both the letter and the stand-by arrangement (in the case of arrangements). These clauses could be invoked if it appeared that policies were not appropriate to the achievement of the objectives of the program. In addition, mid-term reviews were included in 6 programs (Uruguay 1980, El Salvador, Zimbabwe, Uruguay 1981, Vietnam and Guinea-Bissau) to assess the progress made to date, to discuss further policy actions that might be needed and to set targets for the remainder of the program period. In two of these cases (Vietnam and Guinea-Bissau), mid-term reviews were part of programs supported by outright purchases, and in both cases the reviews encompassed the exchange and trade system.

Table 8. Quarterly Targets/Benchmarks in Programs Supported by First Credit Tranche Transctions

	Net Domestic Assets 1/	Net Credit to Gov. 1/	Fiscal Deficit/ Surplus 2/	External Debt 3/	Net Foreign Assets 4/	Other
Uruguay (1980)	C.B.		G			
El Salvador	C.B.					5/
Zimbabwe	B.S.	B.S.		C/G (1-10)		
Uruguay (1981)	C.B.		G			
Guatemala	C.B.	C.B.				
China (1986)	B.S.,C.B.			C/G (1-15)(1-5) Stock S-T 6/		
Venezuela	C.B.	C.B.	G,NFPS		C.B., T	7/
Algeria	B.S.	B.S.	G	D of C/G (1-12) (less than 1)	C.B.	8/
Chile	C.B.		NFPS	C/G (1-10)(1-5) Stock S-T	C.B.	

Sources: Executive Board documents.

1/ C.B.=central bank and B.S.=banking system.
2/ G=treasury or central administration and NFPS=nonfinancial public sector.
3/ C/G=contracting or guaranteeing of nonconcessional external debt by the government with maturities indicated in parenthesis and S-T=short term debt.
4/ C.B.=of the central bank and T=total.
5/ Gross credit of the central bank to financial intermediaries.
6/ Short-term debt of the Bank of China and net foreign liabilities of financial institutions.
7/ External current account and reserve money.
8/ External payments arrears.

e. Progress toward program objectives 1/

About one-third of the programs achieved their growth objectives; only 3 of 11 that specified objectives for inflation met those goals; and one-third met their goals for the overall external balance (Table 9). In a somewhat higher number of programs, performance with respect to these variables improved in the program year compared to the year prior to the program. The programs were more successful in the area of the external current account: well over half of the programs met their current account targets and performance improved relative to the previous year.

The relatively poor record with regard to the achievement of the overall balance of payments objectives reflected a weaker than projected capital account. Shortfalls in disbursements may have been associated with a lack of concrete assurances regarding external financing at the time of program formulation. In some cases a weakening in the overall balance of payments position resulted in a drawdown of relatively high international reserve levels. Also, in all cases with external payments arrears at the outset, the level of arrears increased further during the program period, notwithstanding the programmed reduction in arrears and the general injunction against intensification of restrictions.

Programs that were approved in the latter part of the 1980s were more successful in achieving program objectives, and in improving economic performance relative to the pre-program period, than those approved earlier in the decade. Factors in this improved performance may have included the more comprehensive nature of the policy packages in the later programs, improvements in program design, and the generally more favorable external environment prevailing in the latter part of the 1980s.

1/ Performance under Venezuela's 1989 program is not included in the experience under first credit tranche programs summarized in this section; the first credit tranche program supported by the purchase approved in March 1989 was replaced by an extended arrangement in June 1989.

Table 9. Macroeconomic Performance Under First Credit Tranche Programs, 1980-89 1/

	Growth		Inflation		Current account balance		Overall balance of payments	
	Better or as program	Better or same as previous year	Better or as program	Better or same as previous year	Better or as program	Better or same as previous year	Better or as program	Better or same as previous year
Uganda		*				...		
Central African Republic							*	
Uruguay (1980)	*			*				*
El Salvador	TNS		TNS		TNS	*		
Cyprus			TNS	*	*	*		*
Vietnam	*	*	TNS	...				
China (1981)	*			*	TNS	*	*	*
Western Samoa			*	*	*	*		
Zimbabwe	*	*	*					
Uruguay (1981)			*	*	*	*		
Guatemala			TNS	*	*	*		
Guinea Bissau		*			*	*		*
China (1986)	*	*			*	*	*	*
Venezuela					*	*	*	*
Algeria		*			*	*		*
Chile					*	*	*	*

Sources: Executive Board documents.

1/ Asterisk indicates program target was met or that performance was better or the same as in the previous year. TNS indicates the target was not specified.

Approximately one-third of the programs that specified fiscal or credit targets met these targets (Table 10). 1/ In about half of the programs the fiscal deficit and rate of credit expansion was lower than in the pre-program year. Countries that met their credit and fiscal policy targets tended to be more successful in meeting the inflation and external objectives of the programs. However, the relationship was not clear-cut, and the number of programs where objectives for financial policies were met was too small in any case to allow strong conclusions to be drawn. Problems were encountered in achieving the projected growth in output both where the financial policy targets of programs were met and where they were not.

The meeting of program targets was closely related to the nature of monitoring. Four of the 6 programs that specified quarterly fiscal targets (either on net credit to government or the fiscal balance) met their broad fiscal objectives, while only 1 of 8 programs without quarterly benchmarks met its fiscal objectives. Similarly, 5 of 8 programs that included quarterly benchmarks for credit expansion met their credit targets, while none of the 6 programs without such benchmarks met their credit objectives.

Weaker-than-programmed fiscal adjustment in most cases reflected over-runs on expenditure (the Central African Republic, Cyprus, Vietnam, and China 1986). All programs that missed fiscal targets had difficulties in containing current expenditures (in particular subsidies and the wage bill) and only in Guinea-Bissau did the slippage reflect over-runs on capital expenditures. Sluggish revenue performance was an additional factor in the Central African Republic, El Salvador and China 1986.

In summary, less than half of the programs that were supported by first credit tranche transactions during the 1980s were successful in meeting financial policy targets or their macroeconomic objectives. A number of members subsequently sought Fund support in the upper credit tranches or under an extended arrangement, including in some instances in the year following the program supported by the first credit tranche arrangement or purchase.

1/ For purposes of assessing progress in meeting fiscal objectives, the change in the fiscal deficit is compared with the change in the deficit targeted at the time the program was framed, rather than on the basis of whether the programmed level for the deficit was achieved. If the deficit in the pre-program year turns out to be higher than originally estimated, a program might not meet its objectives in terms of levels while achieving the targeted improvement in the deficit. If the assessment is based on a comparison of actual versus targeted levels of the fiscal deficit, only 2 of the 14 programs actually met their fiscal objectives. By way of comparison, slightly more than half of 44 upper credit tranche programs in effect in 1985-88 met their fiscal (both in terms of levels and changes) or credit targets. See "Review of Selected Aspects of Conditionality Under Stand-by and Extended Arrangements."

Table 10. Performance with Respect to Financial Policy Objectives 1/

	Fiscal Balance 2/		Credit Policy	
	Better or as program	Better or same as previous year	Better or as program	Lower or same as previous year
Uganda	TNS			
Central African Republic		*		
Uruguay (1980)				*
El Salvador				
Cyprus		*		*
Vietnam		*		
China (1981)	*	*	TNS	
Western Samoa				*
Zimbabwe	*	*	*	*
Uruguay (1981)			*	
Guatemala	*	*	*	*
Guinea-Bissau				
China (1986)				*
Venezuela	*	*		*
Algeria	* 3/	*	*	*
Chile	*		*	*

Sources: Executive Board documents.

1/ Asterisk indicates program target was met or that performance was better or the same as in the previous year. TNS indicates the target was not specified.

2/ The targeted fiscal balance is indicated as met if the change in the fiscal deficit in the program was achieved.

3/ Met the target on the overall deficit on treasury operations, which includes movements in special accounts and net loans and advances to public enterprises.

However, it would not appear that the first credit tranche transactions put the Fund's resources at undue risk, particularly as Fund exposure was low in nearly all cases when the transactions were approved. For two members, the Central African Republic and Uganda, the programs supported by the first credit tranche became the first in a series of programs in what proved to be a difficult adjustment process; however, it must be noted that both countries were adversely affected by political and economic developments that were not foreseen when the first credit tranche programs were framed. Only in the case of Vietnam did arrears to the Fund arise with respect to the first credit tranche purchases.

4. Summary and concluding remarks

The Fund's attitude toward requests for use of its resources in the first credit tranche since the mid-1950's has been characterized as a liberal one, provided that the member is making "reasonable efforts" to solve its problems. Operationally, a key feature distinguishing transactions in the first credit tranche from those in the upper credit tranches is that the former are not subject to performance criteria and phasing. Although this is to some extent a procedural distinction, it can have important substantive implications. The provisions for performance criteria and phasing in the upper credit tranches serve to assure the Fund, as its resources are being disbursed, that the required adjustments are taking place. The absence of such provisions in the first credit tranche, and the possibility of full disbursement at the outset, imply a higher risk that Fund resources will be used without intended policy adjustments in fact being made.

In assessing requests for first credit tranche transactions, the Fund must satisfy itself that the member is making "reasonable efforts" to solve its problems and that there are--as in all cases of the use of its resources--adequate safeguards for the temporary use of those resources. Such safeguards depend fundamentally on the strength of the member's adjustment effort in relation to the balance of payments problem it is seeking to address with the Fund's assistance. The Fund must, therefore, judge whether a policy program presented in support of a first credit tranche request constitutes a reasonable effort in light of the economic circumstances and problems faced by the member. Given the absence of performance criteria and phasing, such judgements need to give particular weight to policies in place when the request is considered, with the member being given the benefit of the doubt with respect to policies to be undertaken at later stages of the program, following approval of the request.

All requests for first credit tranche transactions, whether outright purchases or under standby arrangements, are accompanied by letters of intent describing the members' adjustment programs. The letter, together with the accompanying staff paper, forms the basis for the Fund's assessment whether the member is making reasonable efforts to solve its problems and hence whether there are adequate safeguards to the temporary use of the Fund's resources.

All of the 17 requests for first credit tranche transactions in the 1980s were supported by programs with objectives similar to those of programs in the upper credit tranches--the correction of economic imbalances with a view to achieving medium-term balance of payments viability with price stability and sustainable economic growth. All included undertakings for substantive policy actions, and most were based in part on important policy measures--in particular with respect to fiscal, monetary and exchange rate actions--that had already been implemented by the time the requests were presented to the Executive Board.

On the whole, program objectives for financial policies and the main macroeconomic variables were attained in less than half of the cases. Overall performance was somewhat better under programs undertaken in the latter part of the 1980s, which may be explained in part by the generally more favorable external environment that prevailed in that period and by the more comprehensive nature of policy packages formulated in a medium-term framework. One conclusion that the review of the 1980 programs appears to suggest strongly is that program monitoring, through the establishment of quarterly targets for main financial variables, was of considerable assistance to members in meeting their objectives, despite the absence of performance clauses and phasing. The staff would suggest that such monitoring arrangements be included as a standard element of first credit tranche programs in the future.

In summary, it is difficult to judge the "appropriateness" of the conditionality the Fund is applying with respect to the use of its resources, and assessing conditionality within the first credit tranche is no exception. However, in light of the experience described in this paper, the staff is of the view that the conditionality applied has been broadly appropriate and consistent with the provisions applying to the first credit tranche. Given the experience in meeting financial policy or general economic objectives under programs supported by first credit tranche transactions, and the continued problems experienced by a number of the members concerned, it would be difficult to conclude that the programs were too ambitious or demanding in relation to the problems facing the members.

At the same time, the Executive Board's approval of the requests was in most cases based in part on the existence of concrete policy actions that gave the Board a basis for assessing the reasonableness of the members' efforts and the adequacy of the safeguards thereby provided for the temporary use of the Fund's resources. Despite the generally limited success of the programs undertaken in the 1980s, it would not appear that the transactions put the Fund's resources at undue risk, both because of policies in place at the time of approval and because Fund credit outstanding was zero or very low at the outset in virtually all cases; in only one case did significant arrears arise with respect to first credit tranche purchases.

The staff notes, however, that the provisions for the "floating" of the CCFF and EFF open the possibility that members may have a high level of Fund credit outstanding at the time a first credit tranche request is made. These facilities and provisions have evolved since the time the Fund's liberal attitude toward first credit tranche purchases was established--when the first credit tranche was necessarily the first recourse to Fund credit--and may give rise to the possibility of a greater degree of risk than was then envisaged with respect to first credit tranche transactions. Although the staff proposes no changes at this time, it would suggest that these provisions be reconsidered in the context of the general review of access policy that is to be undertaken before the increases in quota take effect.

III. Review of the Provisions of the Extended Fund Facility

1. Background

In view of the comprehensive reconsideration of the extended Fund facility undertaken in 1988, the provisions of the EFF were not reviewed in the last conditionality review in 1989. At that time, it was agreed that the provisions of the EFF would be reviewed on the occasion of the current review. 1/

The extended Fund facility is designed to assist member countries whose external payments imbalances have deep structural roots or where slow growth and an inherently weak balance of payments position prevents the pursuit of an active development policy. 2/ Thus, Fund support under the EFF is conditioned on the sustained implementation over a multi-year period of economic programs that combine sound macroeconomic policies with far-reaching structural reforms. Financial assistance under the EFF is intended to be on a scale commensurate with the strength of the macroeconomic adjustment and structural reform effort and with maturities in line with the time frame typically needed for such reforms to take effect.

In 1988, the Executive Board undertook a comprehensive reconsideration of the EFF with a view to enhancing its effectiveness, including in the context of the evolving debt strategy. 3/ This reconsideration followed a period of decline in the use of the EFF by members. Two aspects that

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1/ Decision No. 9189-(89/77), June 19, 1989. Paragraph 3 of the decision indicates that "the Fund will again review the experience relating to programs supported by stand-by and extended arrangements at an appropriate time pursuant to paragraph 12 of the guidelines on conditionality. At that time, the Fund will also review the provisions of the extended Fund facility." Selected Decisions, Fifteenth Issue, p. 76.

2/ Decision No. 4377-(74/114), September 13, 1974. Selected Decisions, Fifteenth Issue, pp. 70-73.

3/ See "Reconsideration of the Extended Fund Facility," EBS/88/7, 1/20/88.

received considerable attention during the discussions were (i) the catalytic role of Fund assistance under the EFF, on the expectation that deep structural reforms in debtor countries and a longer-term commitment of Fund resources would be suitable to elicit support from other creditors, including commercial banks; and (ii) the need for contingent financing to help maintain the reform effort in the face of adverse exogenous shocks. The discussions on the EFF in 1988 were thus related to those leading to the establishment of the compensatory and contingency financing facility (CCFF) in August 1988 and to the strengthening of the debt strategy in May 1989.

In the review, the Board adopted the following changes to the EFF. 1/ First, the possibility of lengthening existing extended arrangements by a fourth year was introduced, where appropriate and at the request of the member. Second, the proportion of purchases under extended arrangements that could be made with ordinary resources was increased with a view to lengthening the maturity of, and reducing the average rate of charge on, such purchases. 2/ And third, semiannual phasing of performance criteria and purchases was allowed, provided that appropriate monitoring of macroeconomic developments, including through quarterly benchmarks, would be ensured. 3/ It was also agreed that in deciding access for extended arrangements, active use would be made, on a case-by-case basis, of the latitude provided within current access limits and, where warranted, of the exceptional circumstances clause.

2. Experience with the revised provisions of the EFF

Since the changes to the provisions of the EFF in June 1988, the Executive Board has approved six extended arrangements--Tunisia (July 1988), the Philippines and Mexico (both in May 1989), Venezuela (June 1989),

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1/ See The Chairman's Summing Up of the Discussion on the Extended Fund Facility (EBM/88/55, 3/31/88), SUR/88/71, 4/5/88. See also the amendments to the EFF decision--Decision No. 8885-(88/89), Selected Decisions, Fifteenth Issue, pages 71-73.

2/ Decision No. 8886-(88/89) states in particular that "under an extended arrangement, purchases [...] will be made with ordinary resources until the outstanding use of ordinary resources in the upper credit tranches and under the extended Fund facility equals 140 percent of the member's quota. Thereafter, purchases will be made with borrowed resources." Previously the mix of ordinary and borrowed resources had been 1:2 until cumulative use of ordinary resources beyond the first credit tranche reached 140 percent of quota, with financing beyond that point from borrowed resources only. Ordinary resources purchased under extended arrangements have a repurchase period of 4 1/2 to 10 years while borrowed resources have a repurchase period of 3 1/2 to 7 years.

3/ Decision No. 8887-(88/89).

Hungary (February 1991) and Poland (April 1991). 1/ All these extended arrangements, with the exception of the Philippines, remain in effect. The arrangement with the Philippines went off track in 1990 when policy slippages were exacerbated by adverse exogenous shocks, and was replaced by a stand-by arrangement in February 1991.

Under these extended arrangements, access levels were substantially higher on average than under stand-by arrangements approved in the same period. Annual access under these arrangements averaged close to 70 percent of members' quotas, compared to average access of about 50 percent of quota under stand-by arrangements.

Two members (Chile and Venezuela) have to date availed themselves of the provision that allows for the lengthening of existing three-year extended arrangements by up to one year. When the Board adopted this provision in June 1988, a key consideration was the need for some flexibility in the time frame when there were delays because of the need to modify policies during the period of the arrangement. However, there may be other circumstances in which extensions may be appropriate, such as when adjustment is proceeding smoothly under the arrangement and an additional period of adjustment is necessary to complete the process, as shown by the case of Chile in 1988. Chile's request in August 1988 for a one-year lengthening of its arrangement reflected the authorities' view that the EFF provided a useful framework for maintaining the momentum of what had been a very successful adjustment effort. In the case of Venezuela, the extension of the arrangement by three months--approved by the Executive Board in December 1990--was to accommodate a rephasing of a purchase that had not been made as a result of delays in concluding the program review.

One objective of the change in the mix of ordinary and borrowed resources under the EFF was to lower the average rate of charge on resources provided under the EFF, relative to resources provided under stand-by arrangements. In fact such a reduction was not achieved in 1989-90, as burden sharing adjustments raised the rate of charge on ordinary resources to an average of about 45 basis points above the rate of charge on borrowed resources. 2/ However, the burden sharing component is refundable and, if one takes into account the possible refund of these contributions (in particular of deferred income), the new mixing ratio could still be considered to have lowered the cost of resources provided under extended arrangements relative to resources provided under stand-by arrangements.

1/ It should be noted, however, that the principal discussions on Tunisia's program were completed before the 1988 changes in the provisions of the EFF.

2/ This was compounded by the fact that under the decision on the substitution of ordinary for borrowed resources adopted on September 17, 1990, substituted resources are subject to the rate of charge applicable to ordinary, not borrowed resources and, therefore, to burden sharing.

The tendency for the rate of charge on ordinary resources to be above that on borrowed resources has been reversed since early 1991.

The change in the mix of ordinary and borrowed resources lengthened the average maturity of resources for countries with extended arrangements approved since mid-1988. More specifically, under the new mixing rules, ordinary resources represented 46 percent of the combined access under the six extended arrangements approved since the June 1988 decision, implying an average repurchase period of 6.2 years. Under the pre-June 1988 mix for the same extended arrangements, ordinary resources would have accounted for only 27 percent of the combined access, with an average maturity of 5.8 years.

To date, semiannual phasing of performance criteria and purchases has been featured only in the Philippines' extended arrangement. In this case, policy implementation, particularly in the monetary area, was uneven in 1989-90. Monetary aggregates rose well above quarterly benchmarks, although the semiannual performance criteria were met as efforts were made to tighten policies around the test dates.

The extended arrangement with Venezuela had originally envisaged a possible shift toward semiannual phasing starting in the second program year, but this has been postponed to the third year, pending further consolidation of the stabilization effort. The continued use of quarterly performance criteria under extended arrangements has reflected the need for close monitoring of economic developments. It has also been important to monitor the situation with respect to the development of external financing packages under the conditions of uncertainty associated with the modified policy on financing assurances. This policy allowed in some cases for the approval of a Fund arrangement before full agreement had been reached with creditor banks on an appropriate financing package. 1/

3. Reconsideration of EFF provisions

The staff is not proposing major changes in the provisions of the extended Fund facility at this time. The review of the provisions of the EFF in 1988 aimed in part at encouraging the use of this facility by members, particularly middle-income countries. As noted in the Board discussion during the reconsideration of the EFF in 1988, success under extended arrangements would require sustained policy implementation over an

1/ See The Chairman's Summing Up at the Conclusion of "Fund Involvement in the Debt Strategy," Executive Board Meeting 89/61, May 23, 1989, Buff 89/89, 5/24/89. Although full financing assurances had not been secured at the time of approval of the extended arrangement for the Philippines, semiannual monitoring was retained because the monitoring procedures had been discussed with the authorities prior to the adoption of the modified financing assurances guidelines. Also, there was a strong expectation--which was fulfilled--that agreement with creditor banks would be reached within a relatively short period of time.

extended period in line with a timetable of structural measures specified at the outset of the arrangement. This entails a particularly strong commitment on the part of the authorities and the need for considerable advance preparation, which would normally take time to muster, suggesting that the number of countries seeking EFF arrangements would tend to be small. 1/

The number of extended arrangements that have been approved since the 1988 review of the EFF may be seen as disappointing. However, the effectiveness of the EFF is not measured by the number of countries that are utilizing the facility at any one time, but by the improved prospects for medium-term viability with sustainable growth that would result from the determined implementation of sound macroeconomic policies and far-reaching structural reforms. Continued high standards of the EFF are important to ensure such outcomes, while maintaining the credibility of the signal it provides for mobilizing international financial support.

As illustrated by the cases of Mexico, the Philippines and Venezuela, extended arrangements have provided an important catalytic role as well as a suitable adjustment framework for officially-supported debt and debt service reduction operations and facilitated their implementation. This reflects the strong linkages between structural economic reforms in a framework of macroeconomic stability and a fundamental restructuring--including through reduction--of the country's contractual obligations and the achievement of medium-term viability. By the same token, debt and debt service reduction without needed structural reforms would add little to the restoration of medium-term viability. This was the main rationale for the Board's guideline that "Fund support for debt reduction would be linked to medium-term adjustment programs with a strong element of structural reform." 2/

The limited experience to date with semiannual performance criteria and the experience of the Philippines has not undermined the case for allowing semiannual performance criteria under extended arrangements, provided that appropriate monitoring of macroeconomic developments is ensured. For example, semiannual monitoring of adjustment programs under the ESAF has generally proven to be effective. The experience suggests, however, that the number of cases where macroeconomic conditions would warrant such semiannual monitoring may be limited. Moreover, it could be appropriate to reinstate quarterly performance criteria in the context of a subsequent review of the arrangement when problems are encountered in meeting semiannual test dates.

The EFF decision as revised in 1988 indicates that the period of an extended arrangement may be lengthened up to four years where appropriate.

1/ See for example "Statement by the Managing Director on the Extended Fund Facility--Further Considerations" (EBM/88/57; March 24, 1988).
2/ The Chairman's Summing Up at the Conclusion of "Fund Involvement in the Debt Strategy," EBM/89/61, May 23, 1989.

In deciding on the circumstances in which a request for the lengthening of an arrangement would be brought to the Board, it would be useful for management and staff to retain some flexibility, as it is not possible to anticipate all the situations where the Fund might need to consider such a lengthening.

One type of circumstance in which the staff could propose a lengthening of an arrangement is where up to an additional year of adjustment is needed beyond the initial three year period to complete the Fund's financial involvement in support of the adjustment process, and where the thrust of the policy measures to be adopted by the member is broadly in line with the program followed to date under the extended arrangement. In these circumstances, further Fund support under the existing arrangement could help provide continuity to the adjustment effort and increase its chances of success. Under this general principle, the staff would not propose the extension of an arrangement in cases where the prospective additional period of Fund financial involvement is clearly longer than one year (either because of policy slippages or exogenous factors). In these circumstances, a new Fund arrangement would seem the preferred approach.

IV. Contingency Provisions in Fund Arrangements Outside the CCFF

1. Introduction

In the past few years, a number of Fund arrangements have incorporated contingency provisions outside the CCFF in the form of adjustable performance criteria, where the adjustments to program targets are contingent upon deviations in one or more key external variables from the path underlying the program. When the general review of the CCFF decision was conducted in April 1990, features of contingency mechanisms built directly into Fund arrangements were compared and contrasted with those under the CCFF.

At that time, it was agreed that the current review of conditionality would look at the experience with contingency mechanisms that have been built into Fund arrangements, and the lessons that can be drawn from the experience. In light of these discussions, the Executive Board could then decide whether it would want to consider developing general guidelines, and perhaps take those issues up in the context of the next review of the CCFF or the next review of conditionality. 1/ In response to the Board request, this section describes contingency provisions in Fund arrangements in the period 1990 to April 1991, reviews experience with the implementation of such provisions in the past few years, and identifies some principles that may need to be considered in the design of such mechanisms.

1/ "Summing Up by the Acting Chairman - Review of the Compensatory and Contingency Financing Facility" EBM/90/53, 4/4/90 (Buff 90/78, April 17, 1990). The CCFF decision is to be reviewed again before end-June 1992.

The use of automatic adjustments to performance criteria has been reviewed on several occasions in the past. In the reviews prior to the establishment of the CCFF, automatic adjustments of performance criteria generally were justified on the grounds that the deviations in performance were related to a few critical factors, mainly shortfalls in external financing items, that were beyond the control of the authorities and that were expected to be temporary. Subsequently, justifications for automatic adjustments to performance criteria within arrangements have been based on a wider range of external factors beyond the control of the authorities, including deviations that might be seen as permanent. 1/

During 1990 and through April 1991, contingency provisions outside the CCFF have been incorporated in 15 annual programs supported by upper credit tranche stand-by and extended arrangements, as well as in the rights accumulation program for Zambia (Appendices I and II). One of these programs--for the Congo--contained contingency provisions for current account variables only; 4 programs--for Mexico, Nigeria, Venezuela and Zambia--included provisions for both current and capital account variables; 2/ and 11 programs had contingency provisions for capital account variables only. 3/ Subsections (2) and (3) below review the contingency provisions in existing arrangements and the experience with such provisions in the recent past. Subsection (4) presents a summary and conclusions.

2. Contingency provisions covering current account variables

a. Features

In general, features of the individual contingency provisions built directly into arrangements are diverse and all, except the Congo, have evolved in the course of earlier Fund-supported or -monitored programs. These provisions also differ with respect to mechanisms under the CCFF in four main respects: (i) the absence of any additional financing from the Fund or other creditors in the event of an unfavorable shock; (ii) the pace at which additional adjustment measures would be introduced if adverse

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1/ "See Program Design and Performance Criteria", EBS/86/211, 9/8/86; "Program Monitoring - Recent Experience", EBS/87/48, 3/2/87; and "Review of Decision Relating to the Compensatory and Contingency Financing Facility", EBS/89/206, 19/30/89.

2/ Contingency provisions with regard to current and capital account variables could be triggered independently in the cases of Mexico, Nigeria and Venezuela, while in the case of Zambia, capital account provisions could only be triggered if the current account provisions were activated.

3/ Costa Rica, Czech and Slovak Federal Republic, El Salvador, Guyana, Hungary, Jamaica, Morocco, Papua New Guinea, the Philippines, Poland, and Yugoslavia. Four of the above countries--Czech and Slovak Federal Republic, Hungary, the Philippines and Poland--had contingency mechanisms covering current account variables under the CCFF.

shocks occurred (the financing-adjustment mix); (iii) the automaticity of adjustments to performance criteria; and, (iv) the absence of a determination of the extent to which deviations in the current account variables covered under the contingency provisions have been largely offset by unforeseen developments in exogenous current account variables not covered under the provisions.

In terms of coverage, the contingency provisions have broadly conformed with the main principles applied to contingency mechanisms under the CCFF. More specifically, the covered variables (i) are exogenous and clearly beyond the authorities' control; (ii) can be projected and monitored in objective, quantitative terms; (iii) are highly volatile; and (iv) represent key external variables of the current account. Indeed, the provisions relate to variables that could be seen as vital to the implementation of the program--export prices of crude oil and petroleum products for the Congo, Mexico, Nigeria and Venezuela, and copper export prices and oil import prices for Zambia.

In each of these cases, moreover, a mechanism was specified ex ante that would trigger the contingency provisions and, with the exception of the Congo, would also allow for the pre-specified automatic adjustment of performance criteria. The contingencies have applied to key current account variables that could have a major effect on the public sector finances, and in particular on public sector revenues. The critical importance of one or two variables not only made it possible to pre-specify appropriate adjustments to program targets, in particular the level of international reserves and the public sector balance, but also made the design of such a policy response central to the program negotiations. Had the impact of possible shocks been mostly on the private sector, the effects on the public finances and the external accounts would have been more complex and dependent upon the speed and the extent of private sector reaction to the shock; therefore, it would have been more difficult to define ex-ante adjustments. In the case of the Congo, the authorities preferred that the precise modalities of the adjustments to performance criteria be examined in consultation with the Managing Director, at the time the contingency provision was triggered.

The mechanisms vary in their specifications relating to the threshold (i.e., the size of deviation necessary to trigger the mechanism) and the deductible (minimum deviations for which no adjustments are made to performance criteria). 1/ Generally speaking, the provisions do not provide for deductibles, i.e., once the mechanism is triggered, adjustments are made for some proportion of the total deviation. 2/ The provisions for Venezuela and Zambia do not include a threshold.

The mechanisms for the Congo, Mexico and Venezuela provide for a drawdown of international reserves and adjustments to other program targets in the event of unfavorable shocks. For Venezuela, the use of international reserves in 1991 is to be limited by the size of an oil contingency fund that has been built up in the course of the extended arrangement, thereby ensuring that any resources used for contingencies would have been generated by earlier favorable deviations. In Mexico's case, adjustments to performance criteria and use of international reserves is allowed up to specified limits in the event that oil prices are lower than programmed.

The extent to which lower than programmed oil receipts are compensated by a reduction in the international reserve target differs between Mexico and Venezuela. The program for Mexico for 1991 provides for a constant financing proportion for a given deviation in the price of oil, with the financing proportion declining with the size of the deviation. The financing proportion declines from 100 percent for deviations up to US$2 a barrel (which would imply a maximum deviation of US$1 billion a year) to progressively smaller percentages for larger deviations in oil prices, up to a maximum of US$1.4 billion.

In the case of Venezuela, the mechanism in the current program allows for financing of up to 75 percent of the deviation, subject to the constraint that financing in any one quarter is required to be less than 25 percent of the stock of the contingency fund at the start of the quarter. The mechanism for Venezuela could result in declining financing proportions during the program year, but only if an adverse shock persists and the contingency fund is run down over time. The above aspects of the

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1/ The mechanism for the Congo allows for a threshold of 13 percent of the oil price forecast underlying the program before adjustments are triggered (which on the basis of oil export volumes assumed in the program translates into a quarterly balance of payments effect equivalent to about 65 percent of the Congo's quota) while in the case of Nigeria the threshold is 3 percent of the price forecast (with the quarterly balance of payments effect equivalent to about 5 percent of Nigeria's quota). For Mexico, there is a threshold of 12 percent of the central price forecast (which translates into a quarterly balance of payments effect of about 16 percent of Mexico's quota) for favorable deviations, while unfavorable deviations would trigger immediate adjustments to performance criteria.

2/ The mechanism for Venezuela had included a deductible in 1990 but this has been eliminated in the current program. Thresholds have also varied considerably in mechanisms under the CCFF, but a deductible equal to the threshold is required.

contingency provisions differ from the provisions for contingency financing under the CCFF, which generally provide for declining financing proportions over time.

All mechanisms provide for additions to international reserves (and related adjustments to performance criteria) in the event of a favorable shock. However, the extent to which windfall gains (above the threshold and net of the deductible) are saved varies from 100 percent of the excess in the cases of Nigeria and Zambia; 75 percent of the excess for Venezuela; and for Mexico 50 percent of the excess within a certain range, beyond which the proportion saved increases progressively with the size of the windfall. These adjustments remain constant through time. In the case of Zambia, the mechanism is to be activated only in the event that copper prices exceed program projections, but once activated the mechanism makes allowance for a possible offset because of the effect of higher than projected oil import prices and shortfalls in donor assistance.

b. Recent experience

In the past two years, the built-in contingency provisions covering current account variables have all been triggered by favorable deviations in export prices. 1/ (The recent experience with these provisions is described in more detail in Appendix III.) In the programs for Mexico and Venezuela in 1989 and 1990, for Nigeria in 1989 and for the Congo in 1990, the contingency provisions were activated owing to favorable deviations in the prices of petroleum and petroleum products. 2/ Under the Fund-monitored program for Zambia in 1990, copper prices were also higher than assumed in the program; the program for Zambia intentionally employed a conservative baseline projection for copper prices, owing to past problems in projecting this key price, and the lack of international reserves or additional financing to cope with a lower than expected price.

Mexico met most performance tests (adjusted for higher than expected oil prices and a lower than expected LIBOR) in 1989 and in 1990, when oil prices averaged some 25 percent above program projections, as did Nigeria in 1989, when oil prices were some 28 percent higher than the projection underlying the original program. Venezuela also added a substantial

1/ Over the same period 8 arrangements with contingency mechanisms under the CCFF have been approved. In no case has a mechanism been triggered because of an unfavorable shock and no Fund contingency financing has been provided under the CCFF. The symmetry provisions were triggered in the case of Trinidad and Tobago on account of favorable deviations in the export price of petroleum and petroleum products. More recently, the symmetry provisions have been activated for the Czech and Slovak Federal Republic because the import price of petroleum and petroleum products was lower than the baseline.

2/ Adjustments to performance criteria were also made in Mexico in 1989 because of a lower than expected level for LIBOR.

proportion of the gains from oil prices (that were some 14 percent higher than forecast) to reserves in 1989. However, Venezuela did not meet the revised international reserves targets at the end of 1989, nor in the first half of 1990, reflecting a substantial shortfall in external financing mainly because of delays in reaching agreement on the financing package with commercial bank creditors.

Zambia did not meet the end-1990 targets under the Fund-monitored program. In this case, the balance of payments effects of a higher than programmed copper price were more than offset by higher than expected oil import prices, shortfalls in external financing, and higher than programmed debt service payments. In the case of the Congo, the contingency provisions under which the authorities were committed to consult with the Managing Director were triggered in the fourth quarter of 1990 owing to higher oil prices; however, other fiscal policy developments compromised the program and the consultation did not take place.

3. Contingency provisions covering capital account variables

a. Features

As with the provisions covering current account variables, the contingency provisions developed for capital account variables have not called for additional Fund financing in the event of a shortfall in foreign financing but in some cases have allowed for a drawdown of international reserves and adjustments to other related performance criteria. The provisions have covered a range of capital account variables; these include loan disbursements from multilateral development institutions (including the World Bank); inflows of official bilateral assistance in the form of loans and/or grants (including for project financing); co-financing from donor countries; proceeds from the divestment of public companies; enhancements (from own resources) used for debt reduction operations; debt relief and arrears; and private capital flows (including new money from commercial banks). Where the covered capital account variables affected the financing of the public sector, prespecified adjustments have also been included with respect to budgetary, credit and external debt targets.

In most cases, adjustments to performance criteria have been pre-specified and automatic, and with a few exceptions performance criteria are to be adjusted for the full effect of the deviation in financing. In three cases, deviations would be accommodated only on a temporary basis, as adjustments are to be phased out during the period of the arrangement. 1/

1/ The period during which the shortfall needed to be reversed was pre-specified in the programs for Jamaica (for non project loans in the original program) and Guyana (for World Bank and Caribbean Development Bank balance of payments support); for Costa Rica, a Board review is necessary to determine the period during which the adjustment would be maintained.

The mechanisms have generally been symmetrical, but there have been a few instances where adjustments are to be made to performance criteria only in the event of higher than programmed levels of external financing, as well as cases where adjustments are made only for shortfalls. Except for Jamaica, none of the capital account adjusters provided for a threshold, reflecting the lumpiness of the capital account items that were covered, and the fact that shortfalls in financing would often be related to the failure of particular loan disbursements to take place. Similarly, none of the arrangements included a deductible; as a result, performance criteria would be adjusted for at least some proportion of any shortfall or excess in financing.

b. Recent experience

Adjustments related to contingency provisions covering capital account transactions in recent arrangements have reflected mainly shortfalls in programmed external financing. 1/ (The recent experience with contingency provisions covering capital account variables is described in more detail in Appendix III.) Provisions on account of excesses in external financing were triggered only in the 1990 arrangement for Morocco. The mechanisms for El Salvador provided only for adjustments in the event of excesses in certain types of financing while that for Yugoslavia stipulated adjustments in the event of the availability of certain types of financing but these were not activated.

Issues of coverage have arisen in Morocco, Guyana and the Philippines. In Morocco, the excess in external financing was directly related to higher than expected oil prices, but the latter were not covered under contingency provisions. Even though Morocco would have met the adjusted reserve target, by the time the contingency was triggered, the program had already gone off track for reasons unconnected to the contingency. In Guyana, a number of financing items were covered by contingencies, but there was a shortfall in divestment receipts, which were not covered by the contingency provisions; in the event, a waiver was granted for the end-December 1990 test date, in part on the grounds that deviations from targets were smaller than the shortfall in divestment receipts. In the Philippines, a number of specific new financing flows from official and commercial bank creditors were covered by contingencies. Problems were encountered in measuring shortfalls in such financing in 1989 which complicated program monitoring, and the mechanism was simplified in the 1991 arrangement to exclude project financing.

The question of whether shortfalls in official financing were exogenous and beyond the control of the authorities arose for Guyana and Jamaica. In Guyana, there were shortfalls in World Bank and Caribbean Development Bank financing in mid-1990 but contingencies were not triggered because the shortfalls were related to the failure to complete the review of the Fund

1/ Guyana, Jamaica, Mexico, Nigeria, Papua New Guinea, the Philippines and Zambia.

arrangement. In Jamaica, the initial program for 1990 allowed for automatic adjustment of performance criteria for shortfalls in World Bank structural adjustment loans together with cofinancing by donor countries, provided the loans were disbursed within a certain period. In the end, even though the authorities fulfilled the loan conditions, donor cofinancing was not disbursed in the amount envisaged. As a result, in the revised program agreed during the latter part of 1990, the contingency provisions were revised to allow for adjustments to performance criteria in the event of shortfalls in policy-based loans, provided such shortfalls were related to factors beyond the control of the authorities.

4. Summary and issues for considerations

The implementation of adjustment programs is often affected by unexpected changes in external environment and it is important that programs remain resilient to external shocks. With this objective, a number of recent Fund-supported programs have included contingency provisions built directly into the program. At the same time, however, it is necessary that policy responses to changes in the external environment are of appropriate magnitude and timely. To achieve these objectives, the contingency mechanism should be as simple as possible in its design and easy to monitor from an operational viewpoint.

Each of the contingency provisions developed in Fund arrangements are tailored to the particular country situation and differ substantially from one to another. These provisions also differ from contingency mechanisms in the CCFF in that they are more flexible, easier to design and to monitor, and which may explain why they have become more widely used than mechanisms under the CCFF. The principal differences relate to: the absence of any additional Fund or other financing in the event of an unfavorable external shock; the mix between adjustment and financing, including the absence of a deductible; the automaticity of the adjustments to performance criteria; the treatment of the current account variables not covered under the contingency; and the inclusion of adjustments owing to deviations in capital account variables.

To avoid problems of moral hazard, the variables covered by these mechanisms should be exogenous and clearly beyond the control of the authorities. In fact, issues of coverage have not arisen in the case of contingency provisions developed for current account variables. Coverage has been limited to variables that are clearly beyond the authorities' control and that are of vital importance to the implementation of the program. Therefore, these adjustments have featured prominently in the design of the program and have been fully documented in the staff papers supporting request for arrangements.

The fact that the variables have a substantial and well-defined impact on the public finances (rather than impinging on the private sector) has made performance criteria related to these covered variables particularly amenable to pre-specified adjustments. Such adjustments to performance criteria have been automatic and account has not been taken of possible offsets owing to deviations in variables not covered under provisions.

By contrast, appropriate coverage in the case of adjustments for financing items is more difficult to define. The provisions covering capital account variables might apply to a large number of items which in the aggregate may have an important effect on the program, but taken individually may sometimes be relatively small. The inclination to adopt more complicated mechanisms, in the interest of safeguarding the smooth implementation of the program or of ensuring that unexpected inflows are added to international reserves, needs to be balanced against the need to avoid difficulties in measurement and undue complication of the monitoring of arrangements.

In addition, it may be difficult at times to establish objective criteria to assess whether shortfalls are beyond the control of the authorities. For example, such criteria would need to distinguish between lower than anticipated commercial bank or official financing related to policy slippages in the borrowing country and that related to decisions on the part of the creditors that were not linked to policy actions by the borrowing member. Furthermore, the automatic adjustment of performance criteria and the possibility that the member might be able to use international reserves in the event of a shortfall in foreign financing (rather than having the Fund arrangement interrupted) might influence the behavior of other creditors.

More generally, the flexibility for program implementation provided by these provisions needs to be weighed against their implications for issues relating to uniformity of treatment, the policy of financing assurances, and the mix of financing and adjustment measures in the face of an adverse shock. In particular, problems could potentially arise if adjustment clauses were to provide for a substantial reduction in the targeted buildup of international reserves in the event of an unfavorable shock. In such circumstances, two principles would be important: (i) that the drawdown of reserves and the implicit adjustment of current account objectives do not threaten basic program objectives (in particular the achievement of external viability); and (ii) that adjustment policies in response to the shock are credible and in proportion to the shock. Similarly, it would be necessary to ensure that any additional spending allowed under the program, in the event of a favorable shock, is compatible with the absorptive capacity of the country and the inflation objectives of the program.

The experience to date with contingency mechanisms built directly into Fund arrangements has not pointed to major shortcomings, but the above concerns point to some of the principles that need to be considered on an ongoing basis as requests for arrangements including built-in contingency mechanisms are brought to the Board for approval. Therefore, the staff is of the view that, for the present, it is appropriate to continue to have such provisions designed on a case-by-case basis but keeping in mind these principles.

In the past, adjustment clauses for current account variables have been treated comprehensively in Board documents; however, adjustments for capital account variables--which have become more common in recent years--have not received the same degree of attention. It is clear that if the Executive Board is to evaluate the appropriateness of the adjustments on a case-by-case basis, there is a need for Board papers proposing such mechanisms to include clear and comprehensive documentation of the rationale for the inclusion of contingency provisions directly into arrangements and for the particular features of the mechanism. These features would include coverage, the financing-adjustment mix, and the magnitude of the threshold and the deductible. Moreover, the documentation would need to demonstrate the consistency of the drawdown of international reserves under the contingency provisions with Fund's policy on financing assurances, and the compatibility of the adjusted program's current account position and the international reserves level with the achievement of external viability. The staff will closely monitor the design of these provisions in the period ahead in describing them to the Board in individual cases, and the next review of the CCFF and/or conditionality will provide the Board with the opportunity to revisit these issues.

V. Prolonged Use of Fund Resources 1/

1. Introduction

The issue of the prolonged use of Fund resources was raised in the Executive Board at various times in the past year and a half, in particular in discussions on strengthening the cooperative strategy on overdue obligations to the Fund. In expressing concern about prolonged use Executive Directors have stressed the need to protect the revolving nature of the Fund's resources and the monetary character of the Fund. The Board agreed that there was a need to review the existing policy on the use of Fund resources by prolonged users and its application, to determine whether adaptations are needed. 2/

Subsection 2 summarizes the existing policies on prolonged use and subsection 3 reviews the experience in implementing those policies since the last comprehensive review of the subject in early 1986. Subsection 4 discusses the factors underlying prolonged use and subsection 5 considers issues related to the policy on the use of Fund resources by prolonged users. Conclusions are presented in subsection 6.

As in earlier reviews of prolonged use, this discussion focuses on the issue of prolonged use of Fund resources under arrangements in support of

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1/ Prepared together with the Treasurer's Department.
2/ "Summing Up by the Acting Chairman on Strengthening the Cooperative Strategy-Preventive Measures," IS/90/9, 2/7/90 (Buff document 90/37, 2/9/90).

members' adjustment programs, i.e., in cases where a member has made repeated use of Fund resources under arrangements and outstanding use of Fund credit remains at relatively high levels. By comparison with earlier reports, the number of prolonged users of the Fund's general resources in the credit tranches at the end of 1990 had declined substantially since the last comprehensive review of the subject in early-1986.

However, this decline reflected in part a shift to the use of SAF/ESAF resources by several countries, and when use of SAF/ESAF resources is included, the number of prolonged users declined only slightly during this period. In addition, several countries that were identified as prolonged users in the mid-1980s had been declared ineligible to use Fund resources at end-1990 and, for the purposes of this paper, are not included on the list of current prolonged users on the basis of repeated Fund arrangements; this definitional treatment is not meant to imply that the problems are resolved but to reflect the fact that the problems of countries in arrears are being addressed in the context of the Fund's arrears strategy. Nevertheless, as a result of the application of the policy on access for prolonged users, outstanding obligations to the Fund by countries identified as prolonged users in 1985 declined substantially in the period 1985-90.

This section concludes that, as decided in past discussions, it would not be appropriate to adopt rigid access rules for prolonged users or other major changes in the policies on prolonged use. However, access policy would clearly continue to be guided by the objective of reducing over time the outstanding use of Fund resources by prolonged users; this general approach would serve to protect the revolving character of the Fund's general resources, which is of the utmost importance in preserving its monetary character, and also to help shift members to use alternative sources of balance of payments financing, especially the private markets. In addition, it is proposed that staff reports supporting future requests for Fund arrangements by countries identified as prolonged users include a review of past programs as well as an assessment of the factors underlying the members' prolonged use. Finally, in addressing the issue of prolonged use, there may be a need in certain cases to clarify the role of the Fund in relation to other creditors.

2. Policy on prolonged use

When considering prolonged use in the past, Executive Directors have emphasized that a distinction should be made between members that have made adequate progress in improving their external positions and those that have not. 1/ Executive Directors have stressed that difficulties arise when

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1/ "The Chairman's Remarks at the Conclusion of the Discussion on Prolonged Use of Fund Resources," EBM/84/94, 6/15/84 (Buff document 84/98, 6/28/84) and "Summing Up by the Acting Chairman on Strengthening the Cooperative Strategy--Preventive Measures," IS/90/9, 2/7/90 (Buff document 90/37, 2/9/90).

prolonged use is not accompanied by adequate progress toward a viable balance of payments position. Some members that used Fund resources over an extended period in the past have achieved a turnaround in their external positions and have substantially reduced or completely repaid their outstanding liabilities to the Fund. A relatively lengthy period of financial support from the Fund in these cases may well have contributed in an important way to the success of the adjustment effort.

However, the efforts of some other members using Fund resources over an extended period have been characterized by adjustment measures that have proven to be weak in relation to the problems facing the country, or that were not adapted sufficiently to deal with external shocks or other unforeseen developments. Also, some members that have used Fund resources over an extended period have failed to sustain appropriate policies and have subsequently incurred overdue obligations to the Fund.

According to the general guidelines on access developed in 1983, a member's access to Fund resources is to be determined in light of its balance of payments need; the strength of its adjustment effort and resulting ability to make timely repurchases, reflecting the need to preserve the revolving nature of the Fund's resources; and the amount of the member's outstanding use of Fund credit and its record in using Fund resources in the past. 1/ In determining access, the timing and extent of the expected improvement in the member's balance of payments were seen as relevant factors. In most cases, the adjustment was to be completed over a 1-3 year period, before repurchases began to fall due. It was also recognized, however, that in cases where new problems arose before repurchases were completed, the Fund should have the flexibility to provide continued financial support, even though this might prolong the use of its resources beyond the period originally contemplated.

In circumstances where it was clear at the outset that the adjustment period would have to extend beyond three years, Fund financing in each year was to be in moderate amounts, well below the prevailing annual access limits. Such support was to be provided only if there was a prospect of a significant reduction in balance of payments pressures within a reasonable period. Thus, while additional purchases might be foreseen beyond a three year period, the adjustment effort would be such that the member would be in a position to make repurchases on schedule and reduce its liabilities to the Fund over time.

The 1984 review of prolonged use concluded that the existing guidelines for the application of access limits should continue to be applied on a case-by-case basis and that the adoption of rigid rules on access based on the number of consecutive Fund-supported programs, or on the period of a

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1/ "The Chairman's Summing Up of the Conclusion of the Discussion on Criteria for the Amount of Access in Individual Cases," 12/2/83, Selected Decisions, Fifteenth Issue, pages 91-98.

member's outstanding liabilities to the Fund, would not be appropriate. The Board review of prolonged use in early 1986 reaffirmed the conclusions of the 1984 discussion. 1/

The review of prolonged use in 1984 also endorsed a number of changes in policies and procedures aimed at addressing the problem of insufficient adjustment that may accompany prolonged use in some cases. The approach included more detailed analysis of the sensitivity of Fund-supported programs to external shocks; the presentation in staff papers of a review of the historical background to a member's problems to help the Board assess better the quality and strength of the proposed adjustment; more emphasis on the use of monitoring techniques including reviews and prior actions on a selective basis; and the use of end-program performance criteria in multi-year arrangements (incorporated into the 1985 guidelines on performance criteria and phasing of purchases). 2/

3. Developments with respect to prolonged use

In applying the policy on prolonged use, it is necessary to define prolonged use in objective terms. However, it should be recognized that any definition involves some degree of arbitrariness. In assessing the implications of prolonged use for the Fund's practices, it is important to take account of factors such as changes in external circumstances that may have affected members' performance under Fund-supported programs. During the discussions last year on strengthening the arrears strategy, Executive Directors emphasized that the approach to prolonged use in individual cases should depend on a careful assessment of the factors that had led to the continued use of Fund resources.

For purposes of the last comprehensive Executive Board discussion of prolonged use in early 1986, prolonged users were identified as members with 5 or more annual Fund-supported programs in the previous 10 years with outstanding liabilities in the credit tranches of 100 percent of quota or more. 3/ The number of programs supported by the Fund over a certain

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1/ "The Chairman's Remarks at the Conclusion of the Discussion on Prolonged Use of Fund Resources," Buff document 84/94, 6/28/84, and "The Chairman's Concluding Remarks at the Discussion on the Review on Conditionality, Including Issues Relating to Program Design and Prolonged Use of Fund Resources," EBM 86/13, 1/27/86, Buff document 86/15. See also "Ninth General Review of Quotas - The Role and Size of the Fund -- Quantitative Factors" (EB/CQuota/88/11, December 16, 1988).

2/ "Relationship Between Performance Criteria and Phasing of Purchases Under Fund Arrangements--Operational Guidelines," Decision No. 7925-(85/38), 3/8/85, Selected Decisions, Fifteenth Issue, pages 131-133.

3/ "Issues in the Implementation of Conditionality: Improving Program Design and Dealing with Prolonged Use" (EBS/85/265, 12/5/85); see also "Ninth General Review of Quotas--The Role and Size of the Fund--Quantitative Factors," op cit.

period of time provides an indication of the pace of adjustment, as absent unexpected and particularly severe external or other exogenous shocks, a large number of annual programs could suggest insufficient progress in achieving external viability. At the same time, a minimum level of outstanding liabilities in the definition excludes members that have had frequent arrangements but have made relatively little actual use of Fund resources; it also excludes members that may have had high levels of outstanding liabilities to the Fund in the past but have made substantial repurchases in subsequent years.

Based on this definition, the number of prolonged users rose steadily in the first half of the 1980s and subsequently declined, particularly in 1989 and 1990 (Table 11). 1/ The review in early 1986 had identified 23 members as prolonged users as of end-September 1985 (indicated in the lower right hand quadrant of Table 12). According to the same definition, the number of prolonged users declined to 6 by end-1990 (Table 13).

This result is, however, subject to important qualifications. First, at the end of 1990, some 5 members that had been identified as prolonged users as of end-September 1985 had been declared ineligible to use Fund resources because of overdue obligations to the Fund. These members were no longer classified as prolonged users on the basis of the above definition. 2/ Second, in earlier reviews, prolonged use has been identified on the basis of the use of Fund resources under arrangements within the General Resources Account (GRA). However, with the shift by many low-income members from stand-by and extended arrangements to SAF/ESAF arrangements, it would be important to take account of use of resources under SAF and ESAF arrangements in assessing broad trends in prolonged use.

Of course, the establishment of the SAF and ESAF was a deliberate adaptation of Fund policies to help low income countries address macroeconomic and structural problems over the medium-term, and requests for use of concessional resources under these facilities should be considered on their own merits. Also, use by members of SAF/ESAF resources does not directly involve the revolving nature of the Fund's general resources. However, failure to take account of SAF/ESAF use would give an incomplete picture of the extent to which members have been involved in a lengthy adjustment process under Fund-supported programs. Moreover, use of SAF/ESAF resources after a period of adjustment under stand-by or extended arrangements could raise questions about the pace at which members are

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1/ Use of Fund resources under the CCFF and the buffer stock facility may also have implications for the revolving nature of Fund resources. However, consistent with the definition of prolonged use employed in earlier reviews, the use of resources under these facilities is not included in the present evaluation. The inclusion of the use of Fund resources under the CCFF would add only one country to the list of prolonged users at end-1990 indicated in Table 3 and 2 countries to the list indicated in Table 4.

2/ Liberia, Peru, Somalia, Sudan, and Zambia.

Table 11. Members with 5 or More Annual Programs in the Preceding 10 Year Period with Outstanding Purchases/Disbursements of 100 Percent of Quota or More at the End of the Year Indicated 1/

	Excluding SAF/ESAF and Trust Fund	Including SAF/ESAF and Trust Fund
1970	0	0
1975	0	0
1980	4	6
1981	7	8
1982	8	9
1983	17	18
1984	21	22
1985	22	23
1986	25	28
1987	23	31
1988	21	27
1989	15	26
1990	6	20

1/ Excluding purchases under the CCFF and the Buffer Stock Financing Facility.

Table 12. Countries with Credit Tranche Liabilities in Excess of 25 Percent of Quota as of September 30, 1985

Credit Tranche Liabilities in Percent of Quota as of 9/30/85	Number of Programs Supported by Stand-by and Extended Arrangements, January 1976-September 1985 1/							
	1	2	3	4	5	6	7	8 or more
25-50	Belize El Salvador	Grenada Solomon Islands						
50-100	Ethiopia Guatemala Niger	Portugal Zimbabwe	Argentina Bangladesh Sierra Leone Mauritania	Barbados C.A.R.				
100-150		Ecuador Gambia, The Honduras Mali Uruguay	Chile Dominican Republic Guyana Thailand	Romania Western Samoa	Sri Lanka Zaire	Peru Togo		Philippines
150-200		Hungary	Ghana India	Costa Rica Pakistan	Madagascar	Haiti Zambia		
200-250		Brazil		Panama	Dominica Kenya Korea Liberia Mexico Senegal Somalia	Mauritius	Malawi Morocco	
250-300			Uganda					
300-350					Côte d'Ivoire Sudan	Turkey Yugoslavia		
350-400								Jamaica

Source: EBS/85/265, 12/5/85.

1/ Underlining indicates members with overdue obligations to the Fund and declared ineligible to use Fund resources.

Table 13. Countries with Credit Tranche Liabilities in Excess of 25 Percent of Quota as of December 31, 1990

Credit Tranche Liabilities in Percent of Quota as of 12/31/90	Number of Programs Supported by Stand-by and Extended Arrangements, January 1981-December 1990 1/							
	1	2	3	4	5	6	7	8 or more
25-50	Algeria Jordan Cameroon	India Tunisia	Gambia, The Mauritius Honduras Dominican Republic Bangladesh	Dominica Haiti Uruguay Hungary Mauritania	Mali			
50-100	Poland	Guyana Trinidad and Tobago	Pakistan Sierra Leone Peru	Niger Brazil	Kenya Ecuador	Zaire Madagascar Senegal Malawi	Yugoslavia	Togo
100-150				Ghana Argentina Gabon			Philippines	Côte d'Ivoire
150-200		Venezuela		Somalia Panama Zambia			Morocco Chile	Jamaica
200-250				Liberia				
250-300								
300-350				Sudan		Mexico		

Source: Fund documents.

1/ Underlining indicates members with overdue obligations to the Fund and declared ineligible to use Fund resources.

approaching external viability and their capacity to make timely repayments to the Fund in the GRA as well as under the SAF/ESAF.

Including programs supported by SAF/ESAF and Trust Fund resources, an additional 14 members that have undertaken adjustment under SAF/ESAF arrangements in the past few years would be added to the list of prolonged users. 1/ Under this definition, the number of prolonged users rose from 23 at end-September 1985 to a peak of 31 at end-1987, before declining to 20 at end-1990 (indicated in the lower right hand quadrant of Table 14). 2/

Thus, the number of prolonged users of all of the Fund's resources under arrangements can be regarded as little changed between 1985 and 1990. However, reflecting the application of the policy on access for prolonged users as discussed below, the outstanding use of Fund resources of the 23 members identified as prolonged users as of end-September 1985 declined substantially in the period September 1985 to end-1990. In terms of the Fund's general resources, outstanding Fund credit under tranche policies for these members declined from an average of about 224 percent of quota at end-September 1985 to 107 percent of quota at end-1990 (Table 15). Excluding the 5 prolonged users that were in arrears to the Fund and did not reduce their outstanding obligations to the Fund over the past 5 years (or reduced them by only small amounts), average outstanding credit declined from 226 percent of quota in September 1985 to 84 percent of quota at end-1990. Including SAF/ESAF disbursements, the outstanding level of obligations

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1/ Hereafter, references to programs supported by SAF/ESAF include those supported by Trust Fund resources and references to the outstanding level of obligations from SAF/ESAF disbursements include those resulting from Trust Fund loans.

2/ In addition, 4 members that were classified as prolonged users in September 1985 and that had been declared ineligible to use Fund resources by the end of 1990 were no longer classified as prolonged users based on repeated use of the Fund's general resources and/or SAF/ESAF resources. These members were Liberia, Peru, Sudan and Zambia. Somalia, which had dropped out of the list of prolonged users when defined on the basis of repeated use of the Fund's general resources was still classified as a prolonged user when use of SAF/ESAF resources was taken into account.

As noted above, any definition of prolonged use will involve a degree of arbitrariness, and if different criteria were adopted the number of prolonged users would change. For example, if a prolonged user were defined as a member with 5 or more programs in the previous 10 years and outstanding liabilities to the Fund under arrangements of 90 percent of quota or more, the number of prolonged users would be slightly higher than indicated above. However, the overall picture would not change markedly. With the 90 percent cut-off, and if only purchases of general resources are included, the number of prolonged users would have peaked at 25 at end-1986 and end-1987, before declining to 9 at end-1990. If use of SAF/ESAF resources is included, the number of prolonged users would have peaked at 31 at end-1987 and declined to 22 at end-1990.

Table 14. Countries with Credit Tranche and/or SAF/ESAF Liabilities in Excess of 25 Percent of Quota as of December 31, 1990

Credit Tranche and SAF/ESAF Liabilities in Percent of Quota as of 12/31/90	Number of Programs Supported by Stand-by, Extended, SAF and ESAF Arrangements, January 1981-December 1990 1/							
	1	2	3	4	5	6	7	8 or more
25-50	Algeria Jordan Cameroon	India Tunisia Guinea-Bissau	Mauritius Honduras Dominican Republic	Uruguay Hungary				
50-100	Poland	Trinidad & Tobago	Lesotho Chad Burundi <u>Peru</u>	Nepal Mozambique Brazil	Haiti Guinea Sri Lanka Ecuador Tanzania		Yugoslavia Mali Dominica	C.A.R.
100-150				<u>Sierra Leone</u> Argentina Bolivia Gabon	Pakistan		Philippines Bangladesh Mauritania	Zaire Côte d'Ivoire Madagascar
150-200		Venezuela	Guyana	<u>Panama</u> <u>Zambia</u>	<u>Somalia</u>		Uganda Morocco Chile	Jamaica Togo Gambia, The Niger
200-250								Kenya Malawi
250-300				<u>Liberia</u>			Ghana	Senegal
300-350				<u>Sudan</u>		Mexico		

Source: Fund documents.

1/ Underlying indicates members with overdue obligations to the Fund and declared ineligible to use Fund resources.

Table 15. Outstanding Use of Fund Resources 1/

(In Percent of Quota)

	Excluding SAF/ESAF/Trust Fund		Including SAF/ESAF/Trust Fund	
	End-Sept 1985	End-Dec. 1990	End-Sept. 1985	End-Dec. 1990
Côte d'Ivoire	313	118	338	118
Dominican	229	30	229	100
Haiti	150	38	180	58
Jamaica	369	154	369	154
Kenya	241	63	264	210
Korea	235	--	235	--
Liberia 2/	241	234	276	269
Madagascar	172	68	203	146
Malawi	247	92	277	217
Mauritius	236	29	245	29
Mexico	232	356	232	356
Morocco	270	172	296	172
Peru 2/	110	88	110	88
Philippines	131	120	156	120
Senegal	236	89	265	259
Somalia 2/	223	154	248	189
Sri Lanka	125	10	156	80
Sudan 2/	303	303	342	342
Togo	132	59	160	159
Turkey	296	--	296	--
Yugoslavia	317	53	317	53
Zaire	144	62	173	112
Zambia 2/	189	169	203	172
Average of all cases	224	107	242	148
Average excluding members declared ineligible to use Fund resources at end-1990	226	84	244	130

1/ Excluding outstanding purchases under the CCFF and the Buffer Stock Financing Facility. For countries in arrears includes overdue repurchases and excludes overdue charges.

2/ Declared ineligible to use Fund resources as of end-1990.

declined for all prolonged users from an average of over 240 percent of quota to below 150 percent of quota and, excluding members declared ineligible to use Fund resources at end-1990, the decline was from 244 percent of quota to 130 percent of quota.

This decline in the outstanding use of Fund resources reflected average access levels under new arrangements for prolonged users that were well below the maximum annual access limits and, in the majority of cases, below average annual access by other users as well. In the period 1986-1990 there were 29 stand-by and extended arrangements approved for the 23 countries identified as prolonged users in 1985. In 18 of these cases, or about two thirds of the total, access was below the annual average for other users; even in cases where access exceeded the average for other arrangements, virtually all instances involved a reduction in Fund credit outstanding. 1/ The general approach is intended to emphasize the fact that even in cases where extended use of Fund resources would be justified, outstanding use should be reduced to make available resources to the Fund for use by other members, and also to indicate to members the need to improve their creditworthiness so that they could receive alternative sources of balance of payments financing, including from the private markets.

The adjustment performance of the 23 members regarded as prolonged users in 1985, as well as their ability to service obligations to the Fund in a timely fashion, varied considerably during the past five years, and it is difficult to generalize regarding the Fund's experience within this group. In 3 cases--Korea, Mauritius and Turkey--members achieved a substantial turnaround in their balance of payments and repurchased all or almost all of their obligations to the Fund by end-1990. 2/ In addition, 5 members--Côte d'Ivoire, Haiti, Jamaica, Morocco and Yugoslavia--substantially reduced their outstanding obligations to the Fund from end-September 1985 (by about 125 percent of quota or more). On the other hand, at the end of 1990, 5 members identified earlier as prolonged users--Liberia, Peru, Somalia, Sudan and Zambia--had been declared ineligible to use Fund resources.

Seven of the other 9 members--Dominica, Kenya, Madagascar, Malawi, Senegal, Sri Lanka and Togo--have continued their adjustment efforts in the framework of SAF and/or ESAF arrangements and substantially reduced their outstanding credit tranche purchases (by an average of about 140 percent of quota). Including SAF/ESAF loans, outstanding Fund credit to these countries declined by an average of about 55 percent of quota over the period September 1985 through December 1990.

1/ Of this group, only Mexico had an increase in outstanding purchases from the Fund over the period September 1985 to December 1990.

2/ In the case of Korea and Mauritius, a portion of total repurchases during this period was made under the early repurchase provisions.

The remaining two members--Mexico and the Philippines--have contended with major economic imbalances and a heavy external debt burden, and have been affected by adverse external and other exogenous shocks. They have continued to rely upon the Fund for support, including for debt and debt-service reduction operations, in the context of stand-by and extended arrangements. During the period September 1985 to end-1990, outstanding credit tranche purchases of the Philippines declined somewhat while outstanding purchases of Mexico rose substantially.

4. Factors underlying prolonged use

Factors contributing to prolonged use vary among countries, and may be associated with four main considerations: (1) changes in the nature of the balance of payments problems addressed by Fund facilities; (2) problems with the adequacy and mix of policies and program implementation; (3) unexpected weakness of the external environment; and (4) the concerns of certain other creditors.

Fund-supported programs aim at achieving balance of payments viability over the medium term, but the concept of the medium term is not a rigid one. Traditionally, the concept of balance of payments viability was identified with an ability to meet the repurchase schedule of 3-5 years that applies to the Fund's ordinary resources under stand-by arrangements. Since the mid-1970s, however, the Fund has recognized that the reduction of large or entrenched imbalances may call for increased attention to structural measures, sometimes implying longer periods of adjustment. The serious debt problems and the associated difficulty of reviving spontaneous capital inflows facing many developing countries in the 1980s have also led to extended periods of difficult adjustment.

In the circumstances, the character of problems addressed by the Fund has changed, and the Fund has agreed to support members' structural adjustment efforts over longer periods through the extended Fund facility (EFF), and SAF/ESAF, and repurchase/repayment periods under these facilities extend beyond the traditional 3-5 years.

A second factor bearing on prolonged use is that in some cases the adjustment and financing mix has not fully measured up to the evolving needs of the situation. Underestimation of the needed adjustment has occasionally reflected a lack of adequate data and other information and resulted in an incorrect assessment of the size and nature of the necessary policy changes. These difficulties have been compounded by the fact that, in a number of cases, the financial support for the program has not been provided on a sufficiently timely basis or on appropriately concessional terms.

Very often, required policy changes called for difficult political decisions, which governments were sometimes unable to make or sustain. However, in some such cases, an abrupt withdrawal of financial support by the Fund could have worsened the situation for the member by delaying feasible policy improvements. Even in cases where the initial policy package was in line with what was required, policies may have been implemented only partially or not at all. Furthermore, when initial assumptions--for example, with respect to the supply responses to policies--turned out to be overly optimistic, programs sometimes were not adapted quickly enough. The absence of an accurate and timely data base sometimes compounded difficulties in policy implementation.

A third factor contributing to prolonged use has been unforeseen developments in the external environment, for example with respect to the terms of trade, international interest rates and external financial support. When these developments are adverse, they necessarily exacerbate imbalances and increase the need for policy measures or alternative financial support, and may lengthen the period of adjustment. Moreover, the extent or permanence of a weakened external environment, and the need for further adjustment, may be underestimated.

Finally, the continuing financial involvement of the Fund has also reflected the concerns of other creditors. Paris Club creditors have generally made debt reschedulings for Fund member countries conditional upon the existence of an adjustment program supported by the commitment of Fund resources under upper credit tranche stand-by, EFF, SAF or ESAF arrangements. 1/ New money disbursements and reschedulings by commercial banks, as well as debt and debt-service reduction operations, have also generally been linked to Fund arrangements in the upper credit tranches. 2/

The interest of these creditors in continued Fund support has been related to the role that the Fund plays in supporting economic adjustment, and a lengthy period of Fund involvement together with other creditors is related to the general problems that a member has encountered in the adjustment process. However, care would need to be taken to avoid a situation where, although the Fund's role should be mainly one of monitoring a country's macroeconomic situation, creditors seek continued financial involvement by the Fund out of other considerations, such as sharing the financing needs of a country among creditors.

In recent years, there has been parallel involvement of the Fund and the World Bank in almost all the countries that could be considered as prolonged users of the Fund's resources, with the Bank taking into account the Fund's macroeconomic assessment of the member's adjustment program when extending assistance. Under existing Bank policy, the Bank's financial involvement in a member country does not necessarily require Fund financing per se. For example, the criteria for eligibility for assistance under the

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1/ More recently, Paris Club creditors have also agreed to provide reschedulings for countries implementing Fund-monitored programs under the collaborative approach to settling overdue obligations to the Fund.

2/ Commercial banks have also rescheduled debts on the basis of enhanced surveillance by the Fund.

Bank's Special Program for Assistance for Debt Distressed Countries in Sub-Saharan Africa (SPA) include existence of Bank- and/or Fund-supported programs. In practice, however, countries receiving assistance under the SPA, which now include several Fund members that could be considered as prolonged users, have had a program supported by an arrangement under the SAF or the ESAF, as well as by the Bank.

5. Reconsideration of issues related to prolonged use

In the discussions last year on strengthening the arrears strategy, Executive Directors called for prudence in the provision of Fund financial assistance and for a strengthening of the assessment of risks. At the same time, Directors emphasized that the Fund's responsibility is to take on risks that are inescapably associated with support of members' adjustment efforts. Against this background, this section considers the present policy on prolonged use.

Access for prolonged users has been guided by the need to reduce over time the outstanding use of Fund resources by these members. The staff recommends that this general approach should be maintained but believes that it would not be appropriate to introduce special access limits for prolonged users. A cap on outstanding use of Fund credit after a period of prolonged use could limit the ability of the Fund to support a member, say, in a case where the adjustment effort has been materially strengthened and requires relatively large Fund financing, or in the face of adverse external shocks. Special uniform limits on access for members that have not made adequate progress in their adjustment efforts would also not appear appropriate. In situations where the country has undergone a genuine change in its determination to undertake adjustment, rigid guidelines could prevent the Fund from responding appropriately. Finally, the recommendation on access to Fund resources would need to take account of the terms of the Fund resources being committed under new arrangements. 1/

A policy that required access for each arrangement to be below scheduled repurchases could result in access levels that were too low in relation to the prospective needs and the adjustment effort of the member. Such a policy would also arbitrarily link access for individual members to the past pattern of purchases. For example, scheduled repurchases in the period 1991-93 of the 6 members that were identified above as prolonged users on the basis of their use of the Fund's general resources range from 10 to 73 percent of quota a year. For the 14 other members that could be considered as prolonged users on the basis of their use of Fund resources under stand-by, extended and/or SAF/ESAF arrangements, repurchases and/or

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1/ For example, SAF/ESAF disbursements could leave the outstanding use of Fund resources unchanged, but because of their concessional nature result in a substantial lowering of the burden of future debt service payments to the Fund.

repayments in the next three years range from zero to 41 percent of quota (Table 16).

Nevertheless, given the continued incidence of prolonged use since the last review, there may be a need to build on the present policy to assess more thoroughly the factors behind prolonged use, on a country-by-country basis, at the time prolonged users request new arrangements, in order to permit a fuller assessment of appropriate access. Executive Directors suggested in last year's discussions on the arrears strategy that for prolonged users more emphasis should be placed on a full review of the targets, policies and performance under preceding arrangements. This would represent a strengthening of the assessment of past arrangements to be included in staff papers as recommended at the review of prolonged use in 1984. In addition to the review of past experience, staff reports accompanying requests for Fund arrangements by prolonged users could also highlight the prospects for continued need for Fund resources in the future and, where possible, indicate the time frame and circumstances in which the member might no longer need Fund resources in the future.

A comprehensive review of past and prospective developments could provide a historical background for Executive Directors to assess progress in achieving medium-term objectives and the reasons behind past program slippages. The review would enable the Board to evaluate in turn the quality and strength of the proposed adjustment, and the risks of not attaining the medium-term viability necessary to preserve the revolving character of the Fund's general resources or ensure the capacity of the country to repay SAF/ESAF resources.

In light of the evaluation of the individual member's experience, and particularly where progress towards external viability has been slow and outstanding use of Fund credit substantial, access to Fund resources might depend on especially strong policy justification. Efforts to strengthen policy implementation and program monitoring could give greater emphasis to prior actions and frontloading of measures, in particular with respect to factors underlying past policy failures when these can be clearly identified. Furthermore, the building of policy contingencies into programs, in combination with Fund contingency financing if appropriate, could help ensure policy adaptation on a timely basis and increase the probability of continuity of the adjustment effort.

Under this approach, a net reduction in a member's outstanding liabilities to the Fund could generally be sought through a strengthening of programs. In this respect, one possibility would be greater use of stand-by arrangements involving only limited access to Fund resources, but which could serve as a catalyst in mobilizing resources from other creditors and as a basis for Paris Club reschedulings.

The strategy for reducing prolonged use could have implications for the Fund's relations with other creditors, as well as the sharing of the financing of members' economic programs, including from the private markets.

Table 16. Outstanding Use of Fund Resources and Scheduled Repurchases/Repayments

(In percent of quota)

	Fund Credit Outstanding at end-Dec. 1990 1/	Repurchases and/or Repayments Due		
		1991	1992	1993
On the basis of stand-by and extended arrangements				
Chile	185	33	33	41
Côte d'Ivoire	118	46	39	21
Jamaica	154	44	38	36
Mexico	356	69	54	73
Morocco	172	41	32	37
Philippines	120	49	25	10
Average		47	37	36
On the basis of stand-by, extended and SAF/ESAF arrangements				
Bangladesh	134	36	19	13
Gambia, The	175	26	9	--
Ghana	256	28	22	19
Kenya	210	20	41	29
Madagascar	146	38	17	11
Malawi	217	41	37	11
Mauritania	96	28	14	3
Niger	177	25	16	10
Pakistan	107	13	18	20
Senegal	259	41	33	13
Somalia	174	16	9	6
Togo	159	15	19	13
Uganda	156	25	19	3
Zaire	112	27	11	16
Average		27	20	12
Overall average		33	25	19

Source: Fund staff estimates.

1/ Excludes outstanding purchases under the CCFF and the buffer stock financing facility.

Of particular interest would be the case of countries where attainment of viability could not reasonably be expected without a restructuring of the stock of outstanding official bilateral and commercial bank debt. The aim of such debt restructurings would be to arrive at a profile of future debt service payments that the country was expected to be able to meet without further rescheduling. This would require concessional terms in some cases.

Proposals have also been made for far-reaching debt restructurings for the low-income countries which, in a number of cases, could contribute to a definitive resolution of members' balance of payments problems and help limit the need for prolonged financial involvement of the Fund in the future. If creditors were instead to provide concessional cash-flow relief in the form of successive reschedulings to these countries, implying a prolonged period of exceptional financing, the Fund might need to develop procedures for monitoring the macroeconomic situation and reporting to creditors in ways that would not involve continued use of Fund resources.

Restructuring and financing packages have begun to address the problems related to high levels of commercial bank debt through debt and debt-service reduction operations. Under the debt strategy, Fund support for debt reduction operations is linked to medium-term adjustment programs adopted in the context of stand-by or extended arrangements. Moreover, debt and debt-service reduction operations may in some cases involve larger Fund financing through augmentation. The aim is, of course, that the debt reduction facilitated by such financing should expedite the achievement of external viability.

In cases where external viability is not in reasonable prospect, the Fund will need to carefully limit further provision of its resources. Other creditors and sources of funds would then have to assume more of the responsibility for providing appropriate financing. In cases where the reduction of large imbalances is likely to require long periods of adjustment, the Fund could provide support in the early stages of the adjustment process in amounts that would take account of the prospect for a lengthy period of adjustment, to help ensure the establishment of an appropriate macroeconomic framework. However, other creditors may have to continue their contributions, in part to facilitate repayments to the Fund, and there would need to be a clear acknowledgement by creditors of the revolving character of the Fund's resources.

6. Conclusions

In last year's discussion on strengthening the cooperative strategy on overdue obligations, the Executive Board indicated that there was a need to review the existing policy on the use of Fund resources by prolonged users and its application. If the definition of prolonged use is confined to the use of the Fund's general resources under stand-by and extended arrangements, there has been a substantial reduction in the incidence of prolonged use since the subject was last discussed in detail in early 1986. However, to a large extent, the reduction in the number of prolonged users measured in this way reflects the shift by several members to use of SAF/ESAF resources, which are specifically designed to provide concessional assistance over the medium term in support of these programs of structural adjustment. When adjustment programs under SAF/ESAF arrangements are included, the number of members that have made prolonged use of the Fund's resources declined only slightly over the past 5 years. In addition, several members that had been identified as prolonged users at the end of September 1985 but had been declared ineligible to use the Fund's resources at the end of 1990 and fall out of a definition of prolonged use based in part on repeated programs.

In various discussions of prolonged use, Executive Directors have stressed that the basic problems of prolonged use of Fund resources arise when such use is not accompanied by adequate economic adjustment. In some cases, prolonged use of Fund resources has been accompanied by substantial progress toward balance of payments adjustment. In others, members have not made sufficient progress toward external viability, but in some of these instances the Fund continued to be involved as a sharp withdrawal of its support might have worsened the situation for the member. Although the number of prolonged users changed little overall in the period 1985-90, as a result of the application of the policy on access for prolonged users, the average outstanding use of Fund resources of members identified as prolonged users was reduced substantially.

In previous reviews of prolonged use, Executive Directors concluded that rigid rules on access based on various indicators of prolonged use would not be appropriate. The staff is of the view that this conclusion remains valid, both for countries that have adjusted substantially in the past but may have recently been affected by adverse developments, and for those that have been less successful in their efforts but may be at a critical point in their adjustment process. Nevertheless, access for prolonged users should continue to be guided by the need to reduce their outstanding use of Fund resources over time. Maintenance of this general approach would support the timely repayment of the Fund's general resources, and hence protect their revolving character as well as resources provided under SAF/ESAF.

Operationally, the staff would propose that members be identified as prolonged users when they have had 5 or more annual programs in the past 10 years, either under stand-by, extended or SAF/ESAF arrangements, and the outstanding use of Fund resources under such arrangements exceeds 100 percent of quota. In such cases, the amount of further Fund support under arrangements and the conditions attached to such use of Fund resources would be considered on a case-by-case basis in light of a comprehensive review of the country's past experience and the prospects for use of Fund resources in the future. Continued Fund support might call for frontloading of adjustment measures and might be provided only on a limited scale. Thus, regardless of the nature of the arrangement, continued Fund financing would require strong policy justification, and the extent of such financing would take clear account of the prospects for external viability. This general approach, reflecting the Fund's monetary character and the revolving nature of its resources, may have implications for other creditors and for the sharing of members' financing needs over time.

Current Account Contingency Provisions in Fund-Supported Programs Outside the CCFF, 1990-91

	Congo (1990)	Mexico (1991)	Nigeria (1991)	Venezuela (1991)	Zambia (1991)
Associated arrangement	Stand-by arrangement covering 8/27/90-5/27/92 for SDR 28 million or 75 percent of quota	Extended arrangement covering 5/26/89-5/25/92 for SDR 2,797.2 million or 240 percent of quota. Augmented on 1/29/90 to 280 percent of quota	Stand-by arrangement covering 1/9/91-4/8/92 for SDR 319 million or 37.6 percent of quota	Extended arrangement covering 6/23/89-6/23/92 for SDR 3,701 million or 270 percent of quota. Arrangement subsequently augmented, rephased and extended through 9/23/92	Rights accumulation program covering 4/17/91-4/16/94 for rights equivalent to SDR 836.9 million or 310 percent of quota
Covered variables	Oil price	Oil price	Oil price	Cash oil export receipts	Copper export and oil import prices
Nature of mechanism	Symmetric	Symmetric	Activated only if oil prices exceed program assumptions	Symmetric	Activated if copper prices exceed program projections. Once activated, adjustments made for higher than projected oil import prices
Targets or performance criteria affected by adjustment	Not specified	Net international reserves (NIR), net domestic assets of the Central Bank, net credit to the non-financial public sector and various measures of the public sector deficit	Net foreign assets of the Central Bank; net domestic credit of the banking system; and net bank credit to the Federal Government	NIR and the public sector borrowing requirement	NIR
Threshold	US$2.1 per barrel of oil for two continuous months	US$2 per barrel for oil prices higher than programmed; no threshold on the downside	US$0.50 per barrel of oil	Nil	Nil
Deductible	Nil	Nil	Nil	Nil	Nil for copper prices; 10 percent for oil import prices in excess of projections
Percent of deviation to be adjusted/ financed and cap on adjustment financing	To be determined in the context of a consultation with the Managing Director if the price of oil deviates for two consecutive months by more than US$2.1 a barrel from the program assumption of US$16.4 a barrel	Adjustments are made to NIR, net domestic assets and fiscal targets in the event oil prices differ from those assumed in the program 1/	The net foreign assets target and credit ceilings to be adjusted by 100 percent of the deviation in export earnings arising from oil prices in excess of program assumptions. Assumption of US$18.44 per barrel in 1991	The adjustment will equal 75 percent of the cumulative excess. Withdrawals from the oil contingency fund will equal to 75 percent of the shortfall in a quarter, provided they do not exceed 25 percent of the level of the fund at the start of the quarter. Relevant performance criteria will be adjusted accordingly	Performance criteria are to be adjusted for unforseen movement in copper export and oil import prices 2/

1/ No adjustment to performance criteria for oil prices between US$17 and US$19 a barrel; between US$19 and US$20 a barrel the NIR would be adjusted upwards by 50 percent of the incremental oil proceeds (relative to program); by US$250 million plus 75 percent of the incremental for oil export prices between US$20-21 per barrel; and by US$625 million plus the full amount of the incremental above US$21 a barrel. In addition, the related performance criteria will be adjusted by the Mexican peso equivalent of the adjustment to the NIR target. For oil prices between US$17 and US$15 a barrel, the NIR target would be fully adjusted by the shortfall for a maximum of US$1 billion; by US$1 billion plus 50 percent of the incremental export shortfall from prices US$14-15 a barrel; by US$1,250 million plus 25 percent of the incremental export shortfall for prices between US$13-14 per barrel, for a maximum of US$1,375 million. Full policy adjustment would take place below US$13 a barrel. In addition, the credit and fiscal limits are to be adjusted by the Mexican peso equivalent of the adjustment to the NIR target.

2/ The gross reserves target to be adjusted upwards by 100 percent of earnings resulting from copper prices above US$0.96 per pound less (a) 90 percent of the additional oil bill (measured at constant volume) that results from oil prices above US$22 per barrel; and less (b) 100 percent of any shortfall in donor assistance. At the volume of copper exports assumed in the program, the contingency mechanism placed a limit of US$100 million on the contingent adjustment in the target for gross reserves. Fifty percent of any excess copper earnings above US$100 million, net of adjustments for oil prices or donor shortfalls, to be used to make additional payments to the Fund. The floor on NIR to be adjusted upward to reflect the higher gross reserves objective, as well as any further reduction in arrears to the Fund.

Capital Account Contingency Provisions in Fund-Supported Programs Outside the CCFF

Yugoslavia

Stand-by arrangement covering 3/16/90-9/15/91 for SDR 460 million or 75 percent of quota.

The mechanism is activated only when disbursements from the World Bank under the Structural Adjustment Loan (SAL) and the Financial Sector Adjustment Loan for Yugoslavia and disbursements of financial credits from the European Free Trade Association take place. Performance criteria on net foreign assets (NFA) to be adjusted by 100 percent of the above-mentioned disbursements. No threshold or deductible.

Jamaica

Stand-by arrangement covering 3/23/90 to 5/31/91 for SDR 82 million or 56 percent of quota.

The mechanism is symmetric for project-related foreign loans; activated when disbursements from the World Bank and co-financing from donor countries fall short of program targets; activated if (non-project) net medium- and long-term foreign disbursements exceed program targets; activated in the case of disbursements of debt related to the acquisition of an electricity generator. Threshold of US$60 million for adjustment of the NIR target related to deviations in net disbursement of medium- and long-term external debt from program targets. No deductible.

Targets or performance criteria affected by adjustment are net international reserves of the Central Bank (NIR); net disbursements of medium- and long-term external debt; net domestic assets (NDA) of the Central Bank; financing requirement of the Central Government; overall public sector financing requirement (PSFR); and, stock of external payments arrears. Performance criteria on financing requirements to be adjusted 100 percent downwards (upwards) for any shortfall (excess) in disbursement of project-related foreign loans from program targets through end-March 1991. The upward adjustment to the ceiling may not exceed US$20 million; no cap on downward adjustment. The NDA ceilings to be adjusted upward (downward) for any reduction (increase) in the NIR targets. Performance criteria on PSFR and net disbursements of external debt subject to 100 percent upward adjustment for the disbursement of debt related to the acquisition by the Jamaican Public Service Company of an electric generator for US$21.4 million or the disbursement of the debt whichever is less.

Performance criteria on external debt to be adjusted downwards by the reduction in the NIR target owing to temporary delay in World Bank and other donor financing. Performance criteria on NIR to be reduced by 100 percent of the difference between the programmed disbursement and any amounts actually disbursed under a World Bank agricultural sector loan and cofinancing by donor countries by March 31, 1990 provided these loans are disbursed by May 20, 1990. Performance criteria for NIR subject to 100 percent upward adjustment for the deviation in excess of the threshold of net non-project medium- and long-term foreign disbursements from program targets.

In the revised program that was agreed upon in the latter part of 1990, adjustments to performance criteria were kept automatic for project loans, but made judgmental for policy-related balance of payments loans.

Papua New Guinea

Stand-by arrangement covering 4/25/90-6/24/91 for SDR 26.4 million or 40 percent of quota.

Performance criteria on NDA and net credit to the Government to be adjusted by 100 percent of deviations in net external financing of the Central Government (net financing for concessional loans and net financing of commercial loans). Includes inter alia, the counterpart of disbursements under the World Bank SAL, foreign concessional loans by the Asian Development Bank, the European Community and other donors. The mechanism is symmetrical. No threshold or deductible.

Guyana

Stand-by arrangement covering 7/13/90-7/12/91 for SDR 40.5 million or 100.6 percent of quota.

The mechanism is activated when combined disbursements of non-project balance of payments assistance from the World Bank and the Caribbean Development Bank (CDB) are lower than programmed, when debt service payments are lower than programmed and when bridge loans to the Bank of Guyana and bilateral cash assistance to the Government of Guyana for payments of arrears to international financial institutions deviate from program assumptions. Performance criteria on NFA and gross international reserves (GIR) to be adjusted by 100 percent of the shortfall of actual World Bank and CDB disbursements; adjustment applies up to a pre-specified maximum in a particular quarter with no adjustment thereafter. Performance criteria for GIR to be adjusted upwards by 100 percent of the difference between cumulative debt service payments incorporated in the program and actual debt service payments made. Performance criteria for GIR and NDA of the Bank of Guyana to be adjusted for deviations from program assumptions in external financing for payments of arrears to international financial institutions. Performance criteria on the reduction in the stock of domestic public debt to be lowered by the shortfalls in disbursements of non-project balance of payments loans and grants (adjustments apply up to a pre-specified maximum in a particular quarter) and to be increased by the difference between the programmed and actual debt service payments of the nonfinancial public sector. Performance criteria for the net borrowing requirement to be adjusted upward for incremental social expenditure if such expenditure is financed from abroad. No threshold or deductible.

Morocco

Stand-by arrangement covering 7/20/90-3/31/91 for SDR 100 million or 32.6 percent of quota.

The mechanism is activated when net external financing to the Treasury exceeds program projections. Revision of the performance criteria on NFA of the Central Bank upwards, net bank credit to the Government downwards, and total bank credit downwards by 100 percent of any net external financing to the Treasury including rescheduling of direct external debt, delayed payments, and grants in excess of program projections that are not used for debt buyback operations. No threshold or deductible.

El Salvador

Stand-by arrangement covering 8/27/90-8/26/91 for SDR 35.6 million or 40 percent of quota.

The mechanism is activated only when the amount of programmed refinancing of non-financial public sector obligations to official creditors (excluding deferred interest obligations in 1990) exceeds projected amount. Performance criteria on net domestic bank credit to the non-financial public sector to be adjusted downwards by 100 percent of any excess in the amount of programmed refinancing of non-financial public sector external obligations to official creditors (excluding deferred interest obligations in 1990). Performance criteria on NDA to be adjusted downwards and NIR of the Central Bank adjusted upwards by 100 percent of any excess (relative to projections) in the amount of refinancing of external obligations to external creditors.

Venezuela

Annual program for 1991 under the extended arrangement covering 6/23/89-6/23/92 for SDR 3,701 million or 270 percent of quota. Arrangement subsequently augmented, rephased and extended through 9/23/92.

Performance criteria on NIR and cumulative net disbursements of public sector medium-term external credits to be adjusted in the event that the use of international reserves to purchase enhancements for debt reduction operations deviate from program projections. No threshold or deductible.

Czech and Slovak Federal Republic

Stand-by arrangement covering 1/7/91--3/7/92 for SDR 619.5 million or 105 percent of quota.

Gross reserves would be adjusted upwards (downwards) by 100 percent of any excess (shortfall) in balance of payments support relative to program projections (loans from Bank for International Settlements, other international financial institutions, foreign banks or foreign governments), thus keeping the performance criteria on NIR unchanged. Performance criteria on net credit to the government to be adjusted downward by 100 percent of any disbursement of foreign loans. No threshold or deductible.

Nigeria

Stand-by arrangement covering 1/9/91-4/8/92 for SDR 319 million or 38 percent of quota.

Performance criteria for NFA of the Central Bank, net domestic credit of the banking system and net bank credit to the Federal Government to be adjusted for: (i) 100 percent of deviations in arrears to commercial banks from the amounts contemplated in the program; (ii) 100 percent of deviations in enhancements from own resources that fall short of amounts envisaged under the program or the amount that is not used for debt reduction operations; (iii) 100 percent of divergence of debt relief from program assumptions; and (iv) 100 percent of deviation of balance of payments support from the program target. The mechanism is symmetric. No threshold or deductible.

Mexico

Third year program under the extended arrangement covering 5/26/89-5/25/92 for SDR 2,797.2 million or 240 percent of quota; augmented by 40 percent of quota on January 29, 1990 to SDR 3,263.4 million or 280 percent of quota.

The mechanism is activated only in the event that proceeds received in foreign exchange from sale of public enterprises are in excess of program assumptions. No threshold or deductible. In any calendar quarter beginning January 1, 1991, the performance criteria for NIR are to be adjusted upwards by 100 percent of the difference between 85 percent of the proceeds received in foreign exchange in 1991, and 15 percent of the proceeds received in foreign exchange in 1990 from the privatization of TELMEX. A limit of US$650 million applies to the spending of these proceeds. In addition, the corresponding limit on the NDA, the target on net credit from the Central Bank to the nonfinancial public sector, and on the public sector borrowing requirement are to be lowered, and the targets for the primary surplus of the nonfinancial public sector and the operational surplus of the nonfinancial public sector are to be raised by the same amount. To the extent that proceeds are used for debt reduction, the NIR targets will be adjusted downwards and the related performance criteria will be adjusted accordingly.

Hungary

Extended arrangement covering 2/20/91-2/19/94 for SDR 1114 or 210 percent of quota.

The mechanism is activated only in the case of lower than targeted disbursements of gross medium- and long-term loans (excluding the use of Fund credit and medium-term swaps) and prepayment of principal obligations on medium- and long-term external debt. No threshold or deductible. Performance criteria on NIR to be adjusted downwards for 100 percent of any shortfall in gross disbursements relative to program targets up to a maximum of US$200 million for the second and subsequent quarters; the performance criteria on debt falling due to end-1995 to be adjusted by 100 percent of any prepayment of principal obligations.

Philippines

Stand-by arrangement covering 2/20/91-10/20/92 for SDR 264.2 million or 60 percent of quota.

The mechanism is symmetric. No threshold or deductible. Performance criteria on NIR to be adjusted 100 percent upward (downward) for deviations in cumulative total of new money disbursements, or the equivalent, from foreign commercial banks and disbursement from certain specified loans from official sources or from other program loans, or the equivalent, compared with the 1991 balance of payments projections; and in actual rescheduling of principal and interest by Paris Club creditors. The floor on NIR may be adjusted downwards, in consultation with the Fund, for operations involving debt or debt service operations.

Costa Rica

Stand-by arrangement covering 4/8/91-4/8/92 for SDR 33.64 million or 40 percent of quota.

Performance criteria on NIR to be adjusted upwards by 100 percent of any amount of debt relief granted in excess of program assumptions; adjusted upwards by 100 percent of any drawings on the funds held in escrow as interest guarantees under the debt and debt service reduction package with commercial banks; to be adjusted symmetrically and by 100 percent for delays, considered by the Fund to be temporary, or accelerations in the timing of inflows related to World Bank SAL and balance of payments support from Taiwan Province of China. Performance criteria on NDA of the Central Bank to be adjusted upwards (downwards) for any delay (acceleration) in these inflows by 100 percent, and downwards by 100 percent of any amount of debt relief granted in excess of program assumptions. Performance criteria on net domestic financing of the non-financial public sector to be adjusted downwards (upwards) by 100 percent of any excess (shortfall) in disbursements (relative to projection) associated with SAL lending earmarked for budgetary support. No threshold or deductible.

Zambia

Rights accumulation program covering 4/17/91-4/16/94 for SDR 836.9 million or 310 percent of quota.

The contingency mechanism is activated in the event that copper prices exceed program projections. Once triggered, the performance criteria for

NIR also to be lowered by 100 percent of any shortfall in donor assistance relative to program projections. No threshold or deductible.

Poland

Extended arrangement covering 4/18/91-4/17/94 for SDR 1224 million or 180 percent of quota.

Performance criteria on deficit of the Central Government to be adjusted 100 percent in both directions to the extent that interest and interest related payments (including outlays for collateralization of interest and fees associated with debt reduction) on external debt deviate from amounts envisaged under the program. Performance criteria on net credit of the banking system to the Central Government, and NDA and NIR of the banking system to be adjusted 100 percent in both directions to the extent that the cost of debt reduction operations plus debt service payments (excluding those to the Fund) less any additional financing received by the budget to finance debt reduction deviates from amounts envisaged under the program. Adjustments to performance criteria to be made provided that a debt reduction agreement consistent with the objectives of the program has been finalized with commerical banks.

Experience with Contingency Provisions Outside the CCFF in Recent Fund Arrangements

This section reviews the experience with contingency provisions outside the CCFF in 12 recent programs supported by stand-by and extended arrangements and a rights accumulation program. Two of these programs (Nigeria and the Congo) have contained contingency provisions for current account variables only; three of these programs (Venezuela, Mexico and Zambia) have included provisions for both current and capital account variables; and seven of these programs (Jamaica, Morocco, the Philippines, Guyana, Papua New Guinea, Yugoslavia and El Salvador) have had provisions for capital account variables only.

1. Contingency provisions for current account variables

The contingency provisions in the 1989 stand-by arrangement for Nigeria allowed for automatic adjustments to performance criteria for deviations up to a prespecified amount in oil prices from those assumed in the program. In the event, oil prices in 1989 were higher than projected and at the time of the first review of the program a new contingency mechanism was specified because debt service payments were larger than expected. The new mechanism allowed for adjustments to performance criteria on net domestic credit for deviations in oil prices from the baseline scenario, but equivalent adjustments to net international reserves (NIR) were dropped.

Under the 1990 stand-by arrangement for the Congo, a consultation with the Managing Director was to take place to determine appropriate policy responses and adjustments to performance criteria if oil prices moved outside the range prespecified in the program. In the event, oil prices were above the upper limit of the range in the last quarter of 1990; however, no consultation took place as the program was off track, largely because of slippages in fiscal policy.

2. Contingency provisions for both current and capital account variables

In the extended arrangement for Venezuela, higher than expected oil prices in 1989 triggered an upward adjustment in the NIR target and a downward adjustment in the targeted public sector borrowing requirement (PSBR). At the end of 1989, NIR were below both the adjusted and unadjusted program target, reflecting a substantial shortfall in external financing because of delays in finalizing a financing package with commercial bank creditors. However, the PSBR in 1989 was well within the adjusted program limit.

In 1990, favorable developments in oil prices again triggered adjustments to the program targets. Performance criteria for end-March and end-June on both NIR and the PSBR were met without, but not with, adjustments. At the time of the review of the arrangement in late 1990, when targets and performance criteria for end-December were set, the features of the contingency mechanism were altered and adjustments for performance criteria on NIR were changed. The targets for NIR and for public sector medium-term credits were to be adjusted in the event of the use of reserves, in excess of programmed amounts, in connection with debt reduction operations. In the event, there was a larger use of international reserves than programmed to purchase enhancements for these operations, as there was a shortfall in disbursements, mainly from bilateral agencies. The end-1990 targets for NIR and the cumulative PSBR, unadjusted and adjusted, were met.

The 1989 annual program under the extended arrangement for Mexico featured adjustments to performance criteria if the price of oil and LIBOR deviated from the baseline levels assumed in the program; adjustments were to be made to the extent that the cumulative effect of both variables exceeded pre-specified upper or lower thresholds, with a limit on the maximum adjustment for unfavorable deviations. The 1990 annual program, however, provided for the adjustment of relevant performance criteria only for deviations in the price of oil from the baseline, with pre-specified lower limits beyond which no adjustments were to be made to performance criteria.

Regarding the capital account, the 1989 program provided that the relevant performance criteria would be adjusted for changes in the timing of gross external financing, and the 1990 program provided that to the extent that the structure and timing of the financing package with commercial banks differed from that assumed in the program, the NIR and other related performance criteria would be modified.

In the event, developments in the price of oil and international interest rates in 1989 were more favorable than programmed, resulting in an upward adjustment of the NIR and related adjustments to other performance criteria. In contrast, there were shortfalls in capital inflows which led to adjustments in performance criteria in the opposite direction. All adjusted performance criteria were observed through September 1989. Several end-December performance criteria were not met (with and without adjustment) and a waiver of non-performance was granted in April 1990. In 1990, oil prices were initially lower than assumed under the program, but then reached levels significantly higher than projected, while there was less commercial bank financing than initially envisaged. All adjusted performance tests in 1990 were met. 1/

Under the rights accumulation program for Zambia in 1990, copper prices were higher than program baseline prices which led to the triggering of the contingency provisions. However, there was a shortfall in donor assistance and Zambia made unprogrammed debt service payments to creditors other than multilateral financial institutions and Paris Club. At the same time the oil bill, which was not covered under the contingency provisions, also rose

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1/ As provided for under the program, the March 1990 performance criteria were modified to take account of the final features of the financing package agreed with commercial bank creditors.

sharply in the second half of the year. As a result, reserves did not increase as called for under the contingency mechanism. Quarterly performance criteria on gross foreign reserves, except for end-March 1990, would have been met if there had been no adjustments.

3. Contingency provisions for capital account variables

The contingency provisions with regard to capital account variables as originally formulated in the stand-by arrangement for Jamaica made allowance for automatic adjustment to end-March 1990 performance criteria for shortfalls from program targets for project loans as well as for cofinancing loans associated with World Bank structural adjustment lending, provided that these loans were disbursed before May 20, 1990. In the event, the cofinancing loans were disbursed after the cut-off date for adjustment to performance criteria, although the underlying policy commitments had been implemented by Jamaica as agreed. This problem in timing could have had operational implications, but the program had already gone off track for other reasons.

In the revised program that was agreed in the latter part of 1990, adjustments to performance criteria were kept automatic for project loans, but made judgmental for policy-related balance of payments loans, to ensure that adjustments would be made if the underlying policy conditions for these loans had been met. Adjustments to performance criteria for end-December 1990 and March 1991 were activated owing to shortfalls in project loans and excesses in disbursements of debt related to the acquisition of two electric generators, as provided for in the program. Overall, external public sector financing was less than programmed, and the limit on the overall PSBR was lowered accordingly. Notwithstanding this adjustment, all program targets for December 1990 and March 1991 were met.

In the stand-by arrangement for Morocco, contingency provisions called for adjustments to performance criteria for any excess over programmed amounts in net external financing to the Treasury. In the event, there was a substantial excess in such financing largely related to higher than projected prices for oil imports. Given the design of the program, there would have been a need to adjust performance criteria for end-December 1990 on account of these developments in external financing, including an upward adjustment in the target for net foreign assets (NFA) of the Central Bank. Even though oil price contingencies were not included in the program, Morocco would have met the adjusted performance criteria for the NFA owing to a higher than anticipated level of remittances.

The 1989 extended arrangement with the Philippines included several contingency provisions with regard to capital account variables. The contingency mechanism provided for symmetric adjustments to the floors for the NIR of the monetary authorities for deviations from program assumptions for (i) the rescheduling by Paris Club creditors and commercial banks; (ii) the level of Central Bank resources used in debt reduction operations; and (iii) the cumulative total new money disbursements from foreign commercial banks and official sources. On the basis of Paris Club rescheduling, the NIR targets for end-1989 were adjusted upwards while as a result of debt reduction operations, which involved larger use of Philippines' own resources than envisaged, the NIR targets were adjusted downwards. In net terms, these two adjustments were relatively small.

There were, however, large shortfalls in new money disbursements, mainly from commercial banks but also from official sources (partly related to program implementation). As a result, the NIR floor was adjusted downwards and the adjusted performance criterion on NIR was met. However, problems were encountered with regard to the measurement of the shortfall in "new money" flows, defined as those that were not in the pipeline as of a certain date. More specifically, the underestimation of actual new money flows resulted in a larger downward adjustment in the NIR target for end-September 1989 than was called for. The Philippines was judged to have met the NIR floor, and purchased Fund resources, even though the correctly adjusted NIR floor had not been met. In the 1991 stand-by arrangement, the kinds of loans covered under the new money adjustment clause was substantially reduced, in part to avoid this measurement problem.

In the stand-by arrangement for Guyana, contingency provisions with regard to shortfalls in non-project balance of payments assistance from the World Bank and the Caribbean Development Bank were not triggered in 1990 because the shortfalls were related to the failure to complete the review of the Fund arrangement. Contingency provisions with regard to lower debt service payments and the bridge loan assistance to settle arrears to international financial institutions were activated both in September and December 1990 and some performance criteria, both adjusted and unadjusted, were not met. 1/ No purchases were made under the stand-by arrangement on the basis of September performance criteria, but the December purchase was made on the basis of a waiver. In granting the waiver, it was noted that the deviations from the performance criteria were not large and that had there been a provision for adjustment for shortfalls in financing from the divestment of the telephone company, all performance criteria, except on the stock of domestic debt, would have been met.

In the stand-by arrangement for Papua New Guinea, program targets were adjusted in different directions during the program period, in line with contingency provisions related to capital account variables. End-June 1990 ceilings on net domestic assets and net credit to the government were lowered because of a slight excess in net external financing of the Central Government. Both ceilings were met with wide margins. End-September and end-December credit ceilings were raised in view of substantial shortfalls in external financing, and both ceilings were met. The net effect of contingency provisions in the program was that a larger proportion of the

1/ Contingency provisions with regard to the bridge loan were activated because a small amount of the bridge loan which under the program was assumed to be received by the Bank of Guyana went to the Central Government instead, and resulted in a downward adjustment in the net foreign assets target of the Bank of Guyana.

budget deficit in 1990 was financed from domestic sources than envisaged at the time the program was formulated.

Contingency provisions with regard to capital account transactions were not activated under stand-by arrangements for Yugoslavia and El Salvador. In Yugoslavia, adjustments were to be made only in the event of disbursements from the World Bank under two Structural Adjustment Loans and disbursements of financial credits from the European Free Trade Association; in the event, the first disbursement under SAL-II of the World Bank took place, but Fund purchases were interrupted following the breach of certain performance criteria. The contingency provisions in the stand-by arrangement for El Salvador were not activated as the amount of refinancing of non-financial public sector obligations to official creditors (excluding deferred interest obligations in 1990) did not exceed program assumptions.