

DOCUMENT OF INTERNATIONAL MONETARY FUND AND NOT FOR PUBLIC USE

EBS/88/128

CONFIDENTIAL

July 6, 1988

To: Members of the Executive Board

From: The Secretary

Subject: Draft Decision Relating to Compensatory and
Contingency Financing

The attached draft decision has been added to the agenda of Executive Board Informal Session 88/7, scheduled for today.

Mr. Asser (ext. 7709) or Mr. Francotte (ext. 7798) is available to answer any questions relating to this paper.

Att: (1)



CONFIDENTIAL

INTERNATIONAL MONETARY FUND

Draft Decision Relating to Compensatory
and Contingency Financing

Prepared by the Legal Department

(In consultation with the Exchange and Trade Relations and
Research Departments)

Approved by François Gianviti

July 5, 1988

Attached hereto for the information of the Executive Board is a draft decision on compensatory and contingency financing which reflects the understandings set forth in Buff 88/123, July 1, 1988 (Statement by the Staff Representative to be made at Executive Board Meeting 88/103 on July 6, 1988). The draft decision would be revised as necessary in light of the conclusions reached by the Executive Board.



COMPENSATORY AND CONTINGENCY FINANCING

Section I. General Provisions

1. The Fund is prepared to extend financial assistance, in accordance with the provisions of this Decision, to members that encounter balance of payments difficulties arising out of (i) temporary export shortfalls, (ii) adverse external contingencies, or (iii) excess costs of cereal imports.
2. Purchases under this Decision will be financed with ordinary resources.
3. Purchases under this Decision and holdings resulting from such purchases shall be excluded for the purposes of the definition of "reserve tranche purchase" pursuant to Article XXX (c).
4. For the purpose of applying the Fund's policies on the use of its general resources, holdings resulting from the use of the Fund's resources under any of the policies set forth in this Decision shall be considered to be separate from the holdings resulting from the use of the Fund's resources under any other policy.
5. In order to carry out the purposes of this Decision, the Fund will be prepared to grant a waiver of the limitation of 200 percent of quota in Article V, Section 3(b)(iii), whenever necessary to permit purchases under this Decision or to permit other purchases that would

raise the Fund's holdings of the purchasing member's currency above that limitation because of purchases outstanding under this Decision.

6. The Fund shall indicate in an appropriate manner which purchases by a member are made pursuant to this Decision, and the export shortfall component, the external contingency component and the cereal import cost component of each purchase.

7. When a request for a purchase is made by a member under any Section of this Decision on account of circumstances that have already been taken into account in calculating the amounts of purchases made or to be made under any other Section, double compensation shall be avoided when calculating the amount of the requested purchase.

8. (a) Subject to the other limitations on purchases specified by this Decision, the Fund's holdings of a member's currency resulting from purchases under this Decision shall not exceed any of the following access limits:

(i) a limit of 105 percent of the member's quota on the sum of

- the Fund's holdings of a member's currency resulting from any category of purchases under this Decision, that is, on account of (A) export shortfalls, (B) external contingencies, or (C) excesses in cereal import costs, and

- the Fund's holdings of the member's currency resulting from purchases on account of either one of the other two categories of purchases under this Decision;

(ii) a limit of 83 percent of the member's quota for purchases on account of export shortfalls under Section II

or Section IV if at the time of the request the member's balance of payments position apart from the effects of the export shortfall is satisfactory, and a limit of 40 percent of the member's quota for such purchases in all other cases; (iii) a limit of 40 percent of the member's quota for purchases on account of external contingencies under Section III;

(iv) a limit of 83 percent of the member's quota for purchases on account of an excess in cereal import costs under Section IV if at the time of the request the member's balance of payments position apart from the effects of the excess in cereal import costs is satisfactory, and a limit of 17 percent of the member's quota for such purchases in all other cases; and

(v) a combined limit of 122 percent of the member's quota for purchases on account of export shortfalls under Section II or Section IV, purchases on account of external contingencies under Section III and purchases on account of an excess in cereal import costs under Section IV.

- (b) The limits of 40 and 17 percent above may be exceeded to permit additional purchases under this Decision, provided that the aggregate amount of holdings of the member's currency resulting from such purchases shall not exceed 25 percent of the member's quota.

9. In providing financing pursuant to this Decision, due attention shall be paid to the member's capacity to service its financial obligations to the Fund.

10. Wherever used in this Decision, the expression "Fund arrangement" will mean a stand-by or an extended arrangement. It will also mean a Structural Adjustment Facility (SAF) or Enhanced Structural Adjustment Facility (ESAF) arrangement if:

- (a) the member's program supported by the SAF or ESAF arrangement would, in the Fund's view, meet the criteria of the use of the Fund's general resources in the upper credit tranches; and
- (b) for purposes of Section III, purchases in association with the SAF or ESAF arrangement would not exceed 70 percent of the member's unused access to the general resources of the Fund in the credit tranches and under the Extended Fund Facility.

Section II. Compensatory Financing of Export Fluctuations

11. The Fund is prepared to assist members, particularly primary exporters, encountering payments difficulties produced by temporary export shortfalls, and has decided that such members can continue to expect that their requests for purchases will be met where the Fund is satisfied that:

- (a) the shortfall is of a short-term character and is largely attributable to circumstances beyond the control of the member; and

- (b) the member satisfies the conditions of cooperation with the Fund in accordance with paragraph 12.
12. (a) If the Fund considers that the existing policies of the member in dealing with its balance of payments difficulties are not seriously deficient and that the member's record of cooperation with the Fund in the recent past has been satisfactory, the member may expect that its request for a purchase on account of an export shortfall under this Section or Section IV will be met whenever the purchase would not cause the Fund's holdings of the member's currency resulting from such purchases to exceed:
- (i) 40 percent of the member's quota, if the Fund is satisfied that the member will cooperate with the Fund in an effort to find, where required, appropriate solutions for its balance of payments difficulties; and
 - (ii) 65 percent of the member's quota, if the member has a Fund arrangement under which performance is broadly satisfactory, or if the Fund approves such an arrangement at the time of the request, or if the member's current and prospective policies are such as would, in the Fund's view, meet the criteria for the use of the Fund's general resources in the upper credit tranches.
- (b) If the Fund considers that the existing policies of the member in dealing with its balance of payments difficulties

are seriously deficient or that the member's record of cooperation with the Fund in the recent past has not been satisfactory, the member may expect that its request for a purchase on account of an export shortfall under this Section or Section IV will be met whenever the purchase would not cause the Fund's holdings of the member's currency resulting from such purchases to exceed:

- (i) 20 percent of the member's quota, if the Fund is satisfied that the member has taken action that gives, prior to submission of the request for the purchase, a reasonable assurance that policies corrective of the member's balance of payments problem will be adopted;
- (ii) 40 percent of the member's quota, if the member has a Fund arrangement under which performance is broadly satisfactory, or if the Fund approves such an arrangement for the member at the time of the request, or if the member's current and prospective policies are such as would, in the Fund's view, meet the criteria for the use of the Fund's general resources in the upper credit tranches; and
- (iii) 65 percent of the member's quota, if the member has a Fund arrangement under which a review is completed by the Fund at the time of the request for the purchase, or if the member's current and prospective policies are such as would, in the Fund's view, meet the criteria for completing a review under a Fund arrangement.

(c) Notwithstanding subparagraphs (a) and (b) above, if a member's balance of payments position apart from the effects of the export shortfall is satisfactory, such member may expect that its request for a purchase on account of an export shortfall under this Section or Section IV will be met whenever the purchase would not cause the Fund's holdings of the member's currency resulting from such purchases to exceed 83 percent of the member's quota.

13. If, in the opinion of the Fund, adequate data on receipts from travel and workers' remittances are available, the member requesting a purchase under this Section shall specify whether the receipts shall be included or excluded in the calculation of the shortfall. The choice by the member shall continue to apply for a period of five years.

14. The existence and amount of an export shortfall for the purpose of any purchase under this Section shall be determined with respect to the latest 12-month period preceding the request for which the Fund has sufficient data, provided that a member may request a purchase in respect of a shortfall year for which not more than 6 months of the data on merchandise exports, and 12 months of the data on travel and workers' remittances, are estimated.

15. In order to identify more clearly what are to be regarded as export shortfalls of a short-term character, the Fund, in conjunction with the member concerned, will seek to establish reasonable estimates regarding the medium-term trend of the member's exports based partly on statistical calculation and partly on appraisal of export

prospects. For the purposes of this Section, the shortfall shall be the amount by which the member's export earnings in the shortfall year are less than the geometric average of the member's export earnings for the five-year period centered on the shortfall year. In computing the five-year geometric average, the Fund, in conjunction with the member, will use an estimate based on a judgmental forecast for the period of the two post-shortfall years, provided, however, that any amount by which the forecast for the period of the two post-shortfall years would exceed the member's export earnings for the period of the two pre-shortfall years by more than 20 percent shall not be included in such computation. When the Fund allows a member to purchase under the proviso in paragraph 14, the Fund may use such methods as it considers reasonable for estimating exports during the period for which sufficient data are not available.

16. (a) If the amount of a purchase under the proviso in paragraph 14 on the basis of estimated data exceeds the amount that could have been purchased on the basis of actual data for the full 12-month period under paragraph 15, the member will be expected to make a prompt repurchase in respect of the outstanding purchase, in an amount equivalent to the excess.

(b) If a member requests a purchase on account of an export shortfall under this Section or Section IV in relation to a shortfall year that in whole or in part is included in the period of the two post-shortfall years concerning any earlier purchase under this Section or Section IV, the

amount of the requested purchase shall be calculated so as to take into account any amount by which such earlier purchase differs from the amount that could have been purchased on the basis of data available at the time of the request.

Section III. Compensatory Financing of External Contingencies

17. When approving a Fund arrangement, the Fund will be prepared to decide, at the request of the member, that, should adverse external contingencies occur during the period of the arrangement, it will provide to the member, subject to the provisions of this Section, external contingency financing in association with the arrangement.

18. Such external contingency financing will only be provided to a member facing unanticipated deviations from the baseline projections of one or more key external variables if:

- (a) the deviations from the baseline projections are outside of the control of the member; and
- (b) the member's performance under the associated Fund arrangement is satisfactory; and
- (c) the member is prepared to adapt its adjustment policies as may be necessary to ensure the viability of the program supported by the associated arrangement through an appropriate mix of adjustment and financing.

19. When the Fund approves an arrangement in association with which external contingency financing is to be provided under this Section, it will specify:

- (a) the applicable external contingencies that will be taken into account;
- (b) the maximum amount of external contingency purchases that may be permitted;
- (c) the minimum threshold that must be exceeded before external contingency purchases may be permitted;
- (d) the proportion of the net sum of deviations that will be financed; and
- (e) the maximum amount by which the associated arrangement could be reduced in case of favorable external contingent deviations.

20. The amount of an external contingency purchase shall be determined on the basis of the net sum of the deviations in the individual variables relating to the applicable contingencies. Deviations will be calculated in relation to baseline projections established at the outset of the arrangement or, in case of multiyear arrangements, at the outset of each annual arrangement thereunder or annual segment thereof, as the case may be. The baseline projections shall be clearly described in the member's request for the arrangement or segment thereof.

21. (a) Subject to the other limitations on purchases specified in this Decision, the Fund's holdings of a member's currency resulting from purchases on account of deviations in interest costs shall not exceed 35 percent of the member's quota.

(b) This limitation shall be taken into account in the calculation of the net sum of deviations, except that unfavorable deviations in interest costs shall be included in such calculation without regard to this limitation as required to avoid or reduce a favorable net sum of deviations.

22. The amount of external contingency purchases in association with a Fund arrangement will generally not exceed 70 percent of the amount of the arrangement and, with respect to multiyear arrangements, external contingency purchases will generally not exceed, during any annual arrangement thereunder or annual segment thereof, 70 percent of the amount available under the arrangement during the same period.

23. Purchases by a member under this Section shall be permitted only when the net sum of deviations exceeds the minimum threshold specified by the Fund.

24. Purchases by a member under this Section shall, pursuant to paragraph 18(c), be limited to the proportion of the net sum of deviations determined at the time of adoption of the associated arrangement, provided, however, that such proportion may be changed thereafter by the Fund, at the request of the member, as required to ensure the viability of the member's program supported by the arrangement.

25. (a) Purchases under this Section shall be subject to the observance of any applicable performance criteria, adjusted by the Fund as may be necessary, under the associated arrangement as if such purchases were drawings to be made under that arrangement.

- (b) Purchases under this Decision shall be phased taking into account the expected effects of the net sum of deviations on the program supported by the associated arrangement and the timing of the additional measures to be taken by the member in accordance with paragraph 18(c).
- (c) When, at the request of a member, the Fund has decided to provide financing to the member under this Section that would cause the Fund's holdings of the member's currency resulting from purchases under this Section to exceed 40 percent of the member's quota, the amount of such excess over 40 percent of quota shall not be available under paragraph 8(b) for other purchases under this Decision unless the member notifies the Fund that it will not avail itself of such financing under this Section.

[26. When a member makes a purchase on the basis of estimated data and the amount of the purchase exceeds the amount that could have been purchased on the basis of actual data, the Fund may decide that the member will be expected to make a prompt repurchase in an amount equivalent to the overcompensation.]

27. If, during the period of the associated arrangement for a member, the Fund finds that a favorable sum of net deviations with respect to the contingencies specified pursuant to paragraph 19(a) has occurred:

- (a) when no purchase under this Section has been made by the member during the period of the associated arrangement, or, in the case of a multiyear arrangement, during the period of the current annual arrangement thereunder or annual

segment thereof, the limits on the member's reserves under the associated arrangement shall be increased or the amount of the associated arrangement shall be reduced, or both, as determined by the Fund, in proportion to the size of the favorable net sum of deviations, provided that such adjustment shall be subject to the same threshold as specified pursuant to paragraph 19(c) and shall be limited to the maximum amount of external contingency purchases specified pursuant to paragraph 19(b) or, in the case of a multiyear arrangement, to the amount of external contingency purchases that is available during the period of the current annual arrangement thereunder or annual segment thereof; and

- (b) When one or more purchases under this Section had earlier been made by the member during the period of the associated arrangement, or in the case of a multiyear arrangement, during the period of the current annual arrangement thereunder or annual segment thereof, the limits on the member's reserves under the associated arrangement shall be increased or the amount of the associated arrangement shall be reduced, or both, as determined by the Fund, by the amount of such earlier purchases, to the extent that it does not exceed the favorable sum of net deviations occurred since the latest of any such earlier purchases, provided that the member may choose, instead of a reduction of the amount of the arrangement, to repurchase a corresponding

amount of the Fund's holdings of the member's currency in respect of such earlier purchases.

Section IV. Compensatory Financing of Fluctuations
in the Cost of Cereal Imports

28. For a period of eight years from May 13, 1981, the Fund will be prepared to extend financial assistance in accordance with the terms of this Section to members that encounter a balance of payments difficulty produced by an excess in the cost of their cereal imports.

29. For a period of three years from the date of a member's request for a purchase in respect of cereal imports under this Section, any purchases by the member in respect of its export shortfalls shall be made under this Section instead of under Section II of this Decision.

30. A member with balance of payments difficulties may expect that its request for a purchase under this Section will be met if the Fund is satisfied that:

(a) any shortfall in exports and any excess costs of cereal imports that result in a net shortfall in the member's exports are of a short-term character and are largely attributable to circumstances beyond the control of the member; and

(b) the member satisfies the conditions of cooperation with the Fund in accordance with paragraph 36.

31. (a) Subject to the limits specified in paragraphs 8, 12 and 36, a member may request a purchase under this Section for an amount equal to the net shortfall in its exports calculated

as the sum of its export shortfall and the excess in its cereal import costs.

(b) (i) For the calculation of the net shortfall in exports, an excess in exports shall be considered a negative shortfall in exports and a shortfall in cereal import costs shall be considered a negative excess in cereal import costs.

(ii) An export shortfall shall be determined in accordance with Section II.

(iii) An excess in cereal import costs shall be determined in accordance with paragraphs 32 and 33.

32. The existence and amount of an excess in the cost of cereal imports shall be determined, for the purpose of purchases under this Section, with respect to the latest twelve-month period preceding the request for which the Fund has sufficient data, provided that the Fund may allow a member to make a purchase on the basis of estimated data in respect of a twelve-month period ending not later than twelve months after the latest month for which the Fund has sufficient data on the member's cereal import costs. The estimates used for this purpose shall be made in consultation with the member. The calculation of a member's shortfall or excess in exports and its excess or shortfall in the cost of its cereal imports shall be made for the same twelve-month period.

33. In order to identify more clearly what are to be regarded as excess costs of cereal imports of a short-term character, the Fund, in consultation with the member concerned, will seek to establish

reasonable estimates regarding the medium-term trend of the member's cereal import costs. For the purposes of this Section, the excess in a member's cereal imports for the twelve-month period referred to in paragraph 32 shall be the amount by which the member's cereal imports in that twelve-month period are more than the arithmetic average of the member's cereal imports for the five-year period centered on that twelve-month period.

34. The amount of a purchase under this Section, as defined in paragraph 31, may be either on account of an export shortfall or on account of an excess in cereal import costs, or the amount may consist of two components, one on account of an export shortfall and the other on account of an excess in cereal import costs. The total amount of the purchase and the amount of each component are subject to the limits specified in paragraphs 8, 12 and 36.

35. (a) The part of a purchase relating to an export shortfall, subject to the limits in paragraph 8, shall not exceed the lesser of the export shortfall defined in paragraph 31(b)(ii) and the net shortfall in exports defined in paragraph 31(a).

(b) The amount of a purchase relating to an excess in cereal import costs, subject to the limit in paragraph 8 shall not exceed the lesser of the excess in cereal import costs defined in paragraph 31(b)(iii) and the net shortfall in exports defined in paragraph 31(a).

36. (a) The provisions of paragraph 12 shall apply to purchases on account of export shortfalls under this Section.

[(b) If the Fund considers that the existing policies of the member in dealing with its balance of payments difficulties are not seriously deficient and that the member's record of cooperation with the Fund in the recent past has been satisfactory, the member may expect that its request for a purchase on account of an excess in cereal import costs under this Section will be met whenever the purchase would not cause the Fund's holdings of the member's currency resulting from such purchases to exceed:

- (i) 17 percent of the member's quota, if the Fund is satisfied that the member will cooperate with the Fund in an effort to find, where required, appropriate solutions for its balance of payments difficulties; and
- (ii) 42 percent of the member's quota, if the member has a Fund arrangement under which performance is broadly satisfactory, or if the Fund approves such an arrangement at the time of the request, or if the member's current and prospective policies are such as would, in the Fund's view, meet the criteria for use of resources in the upper credit tranches.

(c) If the Fund considers that the existing policies of the member in dealing with its balance of payments difficulties are seriously deficient or that the member's record of cooperation with the Fund in the recent past has not been satisfactory, the member may expect that its request for a purchase on account of an excess in cereal import costs

under this Section will be met whenever the purchase would not cause the Fund's holdings of the member's currency resulting from such purchases to exceed:

(i) 17 percent of the member's quota, if the Fund is satisfied that the member has taken action that gives, prior to submission of the request for the purchase, a reasonable assurance that policies corrective of the member's balance of payments problem will be adopted; and

(ii) 42 percent of the member's quota, if the member has a Fund arrangement under which a review is completed by the Fund at the time of the request for the purchase or if the member's current and prospective policies are such as would, in the Fund's view, meet the criteria for completing a review under a Fund arrangement.]

(d) Notwithstanding subparagraphs (b) and (c) above, if a member's balance of payments position apart from the effects of the excess in cereal import costs is satisfactory, such member may expect that its request for a purchase on account of an excess in cereal import costs under this Section will be met whenever the purchase would not cause the Fund's holdings of the member's currency resulting from such purchases to exceed 83 percent of the member's quota.

37. Where the sum of the export shortfall and cereal import components, as limited by paragraph 8, exceeds 82 percent of the member's quota, the member shall allocate the amount of its purchase as between the two components.

38. (a) When a member makes a purchase on the basis of estimated data and the amount of the purchase exceeds the amount that could have been purchased on the basis of actual data, the member will be expected to make a prompt repurchase in an amount equivalent to the overcompensation.
- (b) If a member requests a purchase on account of export shortfalls under this Section in relation to a shortfall year that in whole or in part is included in the period of the two post-shortfall years concerning any earlier purchase on account of export shortfalls, the amount of the requested purchase shall be calculated so as to take into account any amount by which such earlier purchase differs from the amount that could have been purchased on the basis of data available at the time of the request.
39. (a) Subject to paragraph 38, when a reduction in the Fund's holdings of a member's currency is attributed to a purchase under this Section the member shall attribute that reduction between the outstanding cereal import component and export shortfall component of the purchase.
- (b) When the Fund's holdings of a member's currency resulting from a purchase under this Section or Section II are reduced by the member's repurchase or otherwise, the member's access to the Fund's resources under this Section will be restored pro tanto, subject to the limits in paragraphs 8, 12 and 36.
40. (a) After the expiration of the period referred to in paragraph 29, the total amount of the export shortfall components of a

member's purchases outstanding under this Section shall be counted as having been purchased under Section II, and the resulting total of the amounts outstanding under Section II and the cereal import components outstanding under this Section shall not exceed 82 percent of the member's quota.

- (b) The provisions of Section II shall continue to apply to the export shortfall component of a purchase under this Section after the expiration of the period referred to in paragraph 29 or the expiration of this Section.

41. The Fund will review this Section not later than 13 May, 1989.

Section V. Transitional Provisions

42. Notwithstanding the provisions of paragraph 8, if on _____ [the date of this Decision], the Fund's holdings of a member's currency resulting from purchases on account of export fluctuations exceed 65 percent of the member's quota, purchases under Section III may be permitted up to 40 percent of the member's quota; the member shall not be permitted to benefit from the supplemental access limit of 25 percent of its quota or to make purchases on account of export shortfalls until and to the extent that the Fund's holdings of its currency resulting from purchases on account of export fluctuations shall first have been reduced to below 65 percent of its quota.

43. This Decision shall apply to all purchases on account of export shortfalls that result from requests that have been initiated after _____ [the date of this Decision]; any purchases resulting from prior requests shall continue to be governed by Decision

No. 6224-79/135) until _____ [3 months from the date of this Decision], provided, however, that for the purpose of calculating the Fund's holdings under this Decision such prior purchases shall be deemed to have been made under this Decision.

44. This Decision shall apply to all purchases on account of an excess in the cost of cereal imports that result from requests that have been initiated after _____ [the date of this Decision]; any purchases resulting from prior requests shall continue to be governed by Decision No. 6860-(81/81) until _____ [3 months from the date of this Decision], provided, however, that for the purpose of calculating the Fund's holdings under this Decision such prior purchases shall be deemed to have been made under this Decision.

45. Rule I-6(4) shall be amended by inserting the following new subparagraph (vi):

"or (vi) under the Decision on Compensatory and Contingency Financing (Executive Board Decision No. ____-(88/____)).

46. The Fund will review this Decision not later than _____.

