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CONFIDENTIAL

March 31, 1988

To: Members of the Executive Board

From: The Secretary

Subject: Enhanced Structural Adjustment Facility (ESAF) - Access Limit
and Interest Rate on Loans by the ESAF Trust

Attached for consideration by the Executive Directors is a paper on the initial access limit under the enhanced structural adjustment facility (ESAF) and the interest rate to be charged on loans by the ESAF Trust. Draft decisions appear on pages 8 and 9.

This matter has been scheduled for discussion at an Executive Board Meeting on Friday, April 8, 1988.

Mr. Boorman (ext. 7858), Mr. Leddy (ext. 8332), or Mr. Munzberg (ext. 6675) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Att: (1)

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

Enhanced Structural Adjustment Facility (ESAF)--
Access Limit and Interest Rate on Loans by the ESAF Trust

Prepared by the Exchange and Trade Relations,
Treasurer's, and Legal Departments

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March 31, 1988

I. Introduction

In the period since the Executive Board decision to establish the Enhanced Structural Adjustment Facility (ESAF), discussions of borrowing agreements for the Loan Account and arrangements for contributions to the Subsidy Account have been held with a large number of potential contributors. Staff discussions on a number of borrowing agreements have been completed or nearly completed, and these agreements have been or are expected to be submitted shortly to the Executive Board for approval. In the judgment of the staff, sufficient resources have been committed, and are or will soon be available through agreements on which discussions have been concluded or are expected to be concluded shortly, for the ESAF to be able to begin lending operations in the period immediately ahead.

Before such operations can begin, however, it is necessary for the Executive Board to take decisions establishing the initial access limit under the facility and the interest rate to be charged on loans by the ESAF Trust. Consistent with the views expressed by most Executive Directors during the Executive Board's earlier discussions of ESAF operational arrangements, 1/ in the attached draft decisions it is proposed: (a) that the maximum limit on access under three-year ESAF arrangements be set at 250 percent of quota, with provision that this limit may be exceeded in exceptional circumstances up to a maximum of 350 percent of quota (Attachment I); and (b) that the interest rate on loans by the ESAF Trust be set at one half of one percent per annum (Attachment II).

Section II of this paper describes the current status of commitments of resources available to the ESAF Trust. Section III discusses considerations relating to the establishment of access limits

1/ See Buff Statement 87/260, 12/17/87, pages 2-3 and 5.

under the facility, and Section IV addresses the question of the interest rate to be charged on loans made by the ESAF Trust.

II. Availability of Resources

In evaluating commitments of resources to the ESAF, it is necessary to make assumptions about a number of variables, and particularly about the interest rate charged on loans to the Trust. ^{1/} Lenders to the Loan Account of the Trust have been offered three alternative interest rate bases for their loans: a fixed rate, to apply to all drawings; a floating six-month combined domestic SDR rate; and a fixed rate at the five-year combined domestic SDR rate, to be established at the time of each drawing. ^{2/} When these interest rates were proposed to the Executive Board, the six-month combined domestic rate had recently fluctuated near 6.5 percent, and this rate was subsequently used in the staff's initial calculations of the Trust's subsidy requirements and in providing illustrative calculations to potential contributors.

Except for those loans that are being provided to the Loan Account of the Trust at an interest rate of 0.5 percent per annum or less or in conjunction with fully matching grants, the six-month combined domestic rate has been selected by all lenders with whom discussions have been concluded or have reached an advanced stage. Thus, for the purpose of the present paper, the six-month combined domestic rate is again used as the basis for calculations. Since the earlier discussions and calculations, the six-month combined domestic rate has fallen, with the latest observation (March 23, 1988) calculated at 5.88 percent and the average for the three-month period ended on March 23 calculated at 5.90 percent. In light of these developments, it would seem reasonable to use a rate of 6 percent for the present calculations of subsidy requirements and of the subsidy value of contributions to the Trust.

Contributions to the ESAF as of March 25, 1988 appear in Appendix Table 1 and the accompanying notes. Commitments have been received from 24 countries, including one nonmember. Conversations continue in a positive spirit with several other potential contributors not yet in a position to give a definitive response. Five countries are providing loans to the Loan Account either directly at an interest rate of 0.5 percent per annum (or lower) or in combination with grant contributions to the Subsidy Account sufficient to achieve an effective interest rate of 0.5 percent on their loans. Five countries are

^{1/} Other important variables include the time pattern of disbursements, the rate of interest earned by the Trust on its investments, the period over which contributions to the Subsidy Account are received, and exchange rates relating to those subsidy commitments which are not expressed in SDRs.

^{2/} See "Enhanced Structural Adjustment Facility (SAF)--Proposed Financial Arrangements" (EBS/87/228, 10/29/87).

providing loans to the Loan Account accompanied by grant contributions which are sufficient to achieve an effective interest rate of 0.5 percent on a portion of their loan commitments (or whose size is not yet determined). Three countries are currently committed to provide loans at a market-related SDR interest rate with no subsidy contributions. One country has proposed an arrangement through which it would make disbursements of concessional loans as an associated lender, in connection with disbursements of ESAF loans. Finally, ten other countries are providing contributions only to the Subsidy Account, either in the form of grants or through concessional loans or investments that will permit net interest income to be earned for the Subsidy Account.

The amount of contributions to the Loan Account is currently about SDR 5.4 billion, with the possibility of up to an additional SDR 0.3 billion from Japan if sufficient subsidy becomes available to reduce the interest rate on those resources for borrowing countries to 0.5 percent. Thus, the total amount of loans potentially available at present is SDR 5.7 billion. The staff would not consider it prudent, on the basis of current subsidy commitments, for the Trust to commit this full amount at an interest rate of 0.5 percent per annum. In a few cases it is difficult to predict when discussions on the borrowing agreements will be completed. In addition, additional subsidy contributions need to be sought to enable the Trust to fully utilize loans extended at the six-month combined domestic rate. As indicated in Appendix Table 2, loans of SDR 4.2 billion are or will soon be available for onlending by the ESAF Trust at an interest rate of 0.5 percent per annum on the basis of agreements on which discussions have already been concluded or are expected to be concluded shortly. 1/

The total current subsidy commitment (including both grants and the grant equivalent implicit in the terms of concessional loans to the Trust) is estimated at SDR 2.0 billion, on the assumption that loans to the Loan Account of the Trust would be extended at an interest rate of 6 percent per annum. Additional loan contributions of SDR 0.3 billion and subsidy commitments of SDR 0.5 billion will need to be sought in the coming months to enable the Trust to lend SDR 6 billion at an interest rate of 0.5 percent per annum. 2/ To this end, discussions are continuing with several potential contributors, and the additional loan and grant commitments are expected to be forthcoming during the remainder of this year. Additional contributions can of course be accepted beyond this year.

1/ It should be noted that some of these contributions are subject to legislative approval.

2/ A grant element of SDR 2.56 billion would be required to achieve an interest rate of 0.5 percent per annum on loans totalling SDR 6 billion, assuming that all loans were extended to the Loan Account of the Trust at an interest rate of 6 percent per annum.

III. Access Limit Under ESAF Arrangements

The ESAF Trust Instrument provides that "[a]n initial maximum limit on access to the resources of the Trust shall be established by the Trustee, as a proportion of members' quotas in the Fund, and provision shall be made for a limit up to which that maximum limit may be exceeded in exceptional circumstances. The maximum access limit and the exceptional maximum limit shall be subject to review from time to time in light of actual utilization of resources available to the Loan Account, and in any event not later than March 31, 1989." (Annex to Decision No. 8759-(87/176) ESAF, Section II, Paragraph 2(a)).

In the Chairman's Summing Up of the Board's discussion of ESAF operational arrangements, it was noted that "Directors generally agreed that access under three-year enhanced structural adjustment arrangements will be subject to a maximum access limit of 250 percent of quota. However, Directors . . . agreed that the guidelines should be applied so that the rate of access for all qualifying members would average about 150 percent of quota. It was also indicated that, in highly exceptional circumstances, the maximum could be exceeded, but it was not envisaged that access would exceed 350 percent of quota even in these cases" (Buff Statement 87/260, 12/17/87, page 5). It is now proposed that the Board take decisions to establish these limits as the basis for ESAF lending operations.

The resources available for disbursement under ESAF arrangements include: (a) the resources of the ESAF Trust; (b) amounts available from the Special Disbursement Account (SDA) which have not been utilized under SAF arrangements; and, potentially, (c) amounts made available by associated lenders. As Executive Directors will recall, the calculation of a maximum access limit was based on possible access to the total resources available for lending under the ESAF, rather than just those of the ESAF Trust. This was appropriate since the mix of resources potentially available for disbursement to any individual eligible member under an ESAF arrangement would depend on the extent to which that member had not previously obtained SAF loans (which would not be the same for all members) as well as the amount of resources that may have been committed to the member by associated lenders. The access limit will constitute a maximum for access to the total resources for all eligible members under three-year ESAF arrangements, and the limit on access to the resources of the ESAF Trust will be defined as a residual for each individual qualifying member.

The original basis for determining the feasibility of the proposed limit was a set of highly tentative staff projections relating to members' financing requirements, on the assumption that all eligible

members (other than China and India) would qualify for ESAF loans. ^{1/} On this basis, it was judged that the proposed access limits could be prudently accommodated within the resources proposed for the facility, including ESAF Trust resources of SDR 6 billion.

In light of the information now available on potential utilization of ESAF resources, the staff judges it to be reasonable to begin ESAF lending operations with the SDR 4.2 billion of resources currently judged to be available for lending by the Trust at 0.5 percent per annum (as reported above) while retaining the proposed framework for access. It now appears, based on initial staff contacts with ESAF-eligible countries, that countries accounting for less than one half of the quotas of eligible members might qualify for ESAF loans during 1988. This estimate includes a number of countries whose qualification would require not only the adoption of adequate adjustment programs, but also financing packages that would facilitate the elimination of overdue obligations to the Fund. This pace of expected utilization of ESAF resources reflects the fact that many of the eligible countries are still at a relatively early stage in the formulation of adjustment policies, particularly structural policies, that they would adopt under programs to be supported by ESAF arrangements. It is not expected that the remaining ESAF-eligible countries would qualify for ESAF loans this year.

In the access calculations, because of the highly preliminary nature of the underlying projections of financing requirements and because they had not been discussed with the authorities, a margin was incorporated to allow for the possibility that actual financing requirements for some individual members might be significantly higher than projected. It was judged to be likely at that time, because of the existence of such a margin and the possibility that some eligible members might not request ESAF loans, that the access limit could in fact be increased at the first annual review, thereby permitting the provision of additional resources to those countries whose entire

^{1/} See "Enhancement of the Structural Adjustment Facility, Considerations Relating to Access and Monitoring Procedures" (EBS/87/230, 11/9/87). China and India, which are among the member countries with the lowest per capita income, are fully eligible to use ESAF resources. However, the Chinese authorities have indicated that, in the present circumstances, they did not intend to make use of ESAF resources. The Indian authorities have stated that they considered it unlikely that they would borrow from the facility, although this could be considered in the event of a fundamental deterioration in India's balance of payments position. In the Trust Instrument, the Board provided that "[t]o the extent that a member has notified the Trustee that it does not intend to make use of the resources available to the Trust, the member shall not be included in the calculations of the access limits on Trust loans." (Annex to Decision No. 8759-(87/176) ESAF, Section II, Paragraph 2(b)).

remaining financing need could not currently be met from other sources. ^{1/} Moreover, it appears likely that some eligible members will not have a protracted balance of payments need.

Commitments of ESAF resources under the proposed limit could be accommodated for all arrangements likely to be approved this year with ESAF Trust resources of less than SDR 4.2 billion. Moreover, loan availability to the ESAF (or in association with ESAF arrangements) already totals SDR 5.7 billion, or SDR 0.3 billion below the SDR 6 billion objective. This amount falls well within the margin in the calculations, as described above, and additional loan and subsidy contributions are expected later this year. Thus, the staff judges on the basis of presently available information that there can be confidence that three-year commitments could be made on the same basis to eligible members qualifying for the use of ESAF resources after the end of 1988, and that eligible members contemplating the adoption of appropriate adjustment programs can be assured that resources would be available on the scale originally envisaged.

IV. Interest Rate Charged on Loans Made by the ESAF Trust

The ESAF Trust Instrument provides that the interest rate to be charged on outstanding balances of loans by the ESAF Trust will be determined in light of the availability and prospective availability of resources to the Subsidy Account and the rate of interest on resources available to the Loan Account. ^{2/} Interest on Trust loans will be payable semiannually (at end-June and end-December). The Executive Board will need to set the interest rate on Trust loans before the beginning of ESAF lending operations, and to keep that interest rate under review to assure that it is consistent with the provisions of the Trust Instrument. Accordingly, the staff would propose to inform the Board on a six-monthly basis, as early as possible before the beginning of a new interest period, of the status of Trust operations and to bring to the Board's attention any developments that would require a reconsideration of the interest rate for ESAF Trust Loans, in accordance with the Instrument. If at any time it is determined that resources available or committed to the Subsidy Account are likely to be insufficient to bring the interest rate charged to borrowers down to 0.5 percent over the remaining life of the Trust's operations, the Fund is to seek additional resources. Should those additional resources not be forthcoming, the rate of interest on Trust loans would have to be recalculated with a view to reducing the rate to the lowest feasible level that could be applied throughout the operation of the Trust.

^{1/} The access limit is to be reviewed not later than March 31, 1989, taking into account the actual utilization of ESAF resources and the resources judged at that time to be available.

^{2/} Annex to Decision No. 8759-(87/176) ESAF, Section IV, Paragraph 5(a).

In his Summing Up of the Executive Board's discussion of ESAF operational arrangements, the Chairman concluded that most Executive Directors considered it appropriate to set the interest rate on Trust lending at 0.5 percent per annum even if by that time the amount of available or committed resources were not fully sufficient for this purpose, but additional resources were confidently expected. 1/ As reported in Section II above, available subsidy contributions and loans to the ESAF Trust are sufficient on the basis of current assumptions to permit lending of SDR 4.2 billion at an interest rate of 0.5 percent per annum. In addition, the management and staff are actively engaged in discussions with a number of contributors and potential contributors which are confidently expected to lead to additional commitments. In light of the foregoing, the staff is of the view that the rate of interest on Trust loans could be set at 0.5 percent per annum.

It may also be noted that on the basis of present projections, Trust loans actually drawn and outstanding by June 30, 1988, the end of the first interest period for Trust loans, are likely to be small, and that the need for actual subsidy payments for that period is likely to be considerably less than amounts already in hand. Subsidy payments in the relatively small amounts now anticipated for this period would have no material effect on the amount of resources available to meet future subsidy requirements nor, consequently, on the calculations relating to the determination of the interest rate on Trust loans in the future.

Nevertheless, it is necessary that both the Fund and borrowers from the ESAF Trust have confidence that the interest rate on Trust loans could be maintained at 0.5 percent per annum throughout the operation of the Trust. Thus, it is crucial that the expected additional commitments of resources for the Subsidy Account be provided in the near future. 2/

1/ Buff 87/260 (12/17/87), paragraph 2. The Chairman also confirmed the procedures for review and determination of the interest rate charged to Trust borrowers.

2/ The grants and grant equivalent now committed would be sufficient to achieve an effective interest rate of 1.5 percent on ESAF Trust loans of SDR 6 billion, if this higher rate of interest did not change either the terms or the amounts of loans and subsidy contributions that have so far been committed. These calculations assume that all loans were extended to the Loan Account of the Trust at an interest rate of 6 percent per annum.

Decision on Access to the Resources of the
Enhanced Structural Adjustment Facility Trust

The Fund as Trustee under the Instrument to Establish the Enhanced Structural Adjustment Facility Trust decides:

1. In accordance with Section II, Paragraph 2(a) of the Instrument to Establish the Enhanced Structural Adjustment Facility Trust, the initial maximum limit on access of each eligible member to the resources of the Trust shall be set at 250 percent of the member's quota in the Fund, minus any remaining access of the member to the resources of the Structural Adjustment Facility, and minus resources committed to the member for loans in association with Trust loans.
2. The maximum limit in paragraph 1 may be increased in exceptional circumstances not to exceed 350 percent of the member's quota in the Fund, subject to the same deductions as in paragraph 1.

Decision on the Interest Rate on Trust Loans

The Fund as Trustee under the Instrument to Establish the Enhanced Structural Adjustment Facility Trust decides:

In accordance with Section II, Paragraph 4(a) and Section IV, Paragraph 5 of the Instrument to Establish the Enhanced Structural Adjustment Facility Trust, the interest rate on loans from the Trust shall be set at 0.5 percent effective [.....].

Table 1. ESAF--Contributions 1/
(In millions of SDRs)

	Grants, or Grant Equivalents <u>2/</u>	Loans
Austria	26	...
Belgium	55	...
Canada	(128)	300
Chile <u>3/</u>	... <u>4/</u>	12
Denmark	34	...
Finland	28	...
France	(298)	800
Germany	130	700
Italy	(158)	370
Japan <u>5/</u>	309	2,200
Korea	(28)	65
Kuwait	...	50
Luxembourg	4	...
Malaysia	22	...
Mexico <u>3/</u>	(19)	45
Netherlands	51	...
Norway	...	90
Saudi Arabia <u>6/</u>	(85)	200
Spain	(17)	290
Sweden	92	...
Switzerland	(85)	200
Thailand	15	...
Turkey	...	35
United Kingdom	<u>436</u>	...
Total	2,019	5,357 <u>7/</u>

1/ Some of these contributions are subject to Parliamentary approval.

2/ Where shown in parentheses, the grant element has been calculated on the basis of the loan amount indicated, and was not specified by the contributing country. These grant elements reflect the undiscounted amounts necessary to be paid in over 14 years "as needed" to achieve an effective lending rate of 0.5 percent, assuming an interest rate of 6.0 percent on loans to the Loan Account of the ESAF Trust.

The amounts reported for other grant contributions are based on the "as-needed" contribution amount which would have the same present value as the resources committed. Thus, where a grant contribution (or the income derived from a loan or investment in the Subsidy Account) is known to be front-loaded, the figure reported here is increased in proportion to the ratio of its present value to that of grants provided "as needed" over 14 years. Grants committed in local currency are valued at March 18, 1988 exchange rates.

3/ Subject to participation by other Latin American countries.

4/ Chile will make a subsidy contribution in an amount yet to be determined.

5/ The Japanese authorities have agreed to a loan amount of SDR 2.2 billion; additional loan amounts up to SDR 0.3 billion could be provided subject to the availability of further contributions to the Subsidy Account to subsidize those amounts down to 0.5 percent (and only to the extent that total contributions by members do not thereby exceed SDR 6 billion). The first installment of the Japanese grant contribution of SDR 300 million is quite large in relation to the Subsidy Account's needs for that period.

6/ This amount has been offered in an associated lending arrangement. Discussions on modalities continue, and the terms of such lending are yet to be established. These calculations assume that those terms will be the same as those on Trust loans.

7/ With the possibility of additional loan amount of up to SDR 0.3 billion from Japan, this total could rise to up to SDR 5.7 billion.

ESAF--Notes on Contributions

Austria:	Grant-only contribution equivalent to net income from a loan (or investment) of SDR 60 million at 0.5 percent, with the same maturity and grace period as Trust loans.
Belgium:	Grant-only contribution equivalent to net income from a loan (or investment) of SDR 120 million at 0.5 percent. Amount could be up to SDR 66 million, depending on maturity agreed.
Canada:	Contribution of SDR 300 million to Loan Account, accompanied by grants. It is presently anticipated that grants corresponding to loans in excess of SDR 200 million will be made available starting in 1995.
Chile:	Contribution of SDR 12 million to Loan Account. Amount of subsidy contribution yet to be determined.
Denmark:	Grant-only contribution of SDR 9 million per year in 1988-90. Size of grants for 1989-90 depends on maintenance of aid budget.
Finland:	Grant-only contribution of Fmk 30 million in 1988, and Fmk 46 million per year in 1989-90.
France:	Contribution of SDR 800 million to Loan Account, of which SDR 700 million is at 0.5 percent, subject to adjustment in light of the interest rate on Trust loans.
Germany:	Contribution of SDR 700 million to the Loan Account, and <i>subsidy contribution of DM 300 million.</i>
Italy:	Contribution of SDR 370 million to Loan Account, with subsidization necessary to achieve an effective lending rate of 0.5 percent.
Japan:	Grant contribution of SDR 300 million, somewhat front-loaded. Contribution to Loan Account of SDR 2.2 billion. Additional loan amount of up to SDR 0.3 billion could be provided, subject to the availability of further grants to subsidize this additional amount down to 0.5 percent (and only to the extent that total contributions by members do not thereby exceed SDR 6 billion).
Korea:	Contribution of SDR 65 million to Loan Account, accompanied by subsidy needed to achieve an effective lending rate of 0.5 percent.
Kuwait:	Contribution of SDR 50 million to Loan Account.
Luxembourg:	Annual grant contributions of SDR 500,000 per year in 1988-93.
Malaysia:	Grant-only contribution represents net income to Subsidy Account from a loan or investment of SDR 30 million at 0.5 percent in 1988, and, provided the balance of payments situation remains favorable, of a further SDR 10 million in 1989. ^{1/}
Mexico:	Contribution of SDR 45 million to Loan Account, accompanied by subsidy needed to achieve an effective lending rate of 0.5 percent.
Netherlands:	Grant-only contributions totalling f. 135 million in 1988-97.
Norway:	Contribution of SDR 90 million to Loan Account. May seek Parliamentary approval of matching subsidy.
Saudi Arabia:	Authorities have offered to provide concessional loans of SDR 200 million in an associated lending arrangement. Discussions of possible modalities continue.
Spain:	Contribution of SDR 250 million to Loan Account at six-month combined domestic rate, and SDR 40 million at 0.5 percent, subject to final confirmation by the Spanish authorities.
Sweden:	Grant-only contribution of SKr 150 million per year in 1988-91.
Switzerland:	Contribution of SDR 200 million at zero percent to Loan Account.
Thailand:	Loan or investment in Subsidy Account yielding net income of SDR 15 million.
Turkey:	Contribution of up to SDR 35 million to Loan Account.
United Kingdom:	Grant-only contribution equivalent to amounts sufficient, at interest and exchange rates prevailing in early December, to provide necessary subsidy on Trust loans rising to up to SDR 1 billion. Amount calculated on this basis totals 327 million pounds sterling.

^{1/} These amounts are assumed to remain invested for 10 years, at an interest rate of 6.0 percent per annum.

Table 2. ESAF--Current Size of the Facility

(In millions of SDRs)

	Grant, or Grant Equivalent	Loan Amount
A. Loans at 0.5 percent or with matching grants	1,042	2,444
B. Grant-only contributions	762	...
C. Available loan amount which can be subsidized by above grant-only contributions	...	1,789
D. Fully-subsidized loan amount		4,233
E. Other current commitments	215	1,124
F. Total current commitments	2,019	5,357 <u>1/</u>

Source: Appendix Table 1.

1/ With the possibility of additional loan amount of up to SDR 0.3 billion from Japan, this total could rise to up to SDR 5.7 billion.