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EBS/87/190

CONFIDENTIAL

September 2, 1987

To: Members of the Executive Board

From: The Secretary

Subject: Further Considerations on the Mobilization of Resources in
Association with the Structural Adjustment Facility (SAF)

The attached paper provides further information on issues that have arisen in discussions held on the possible enhancement of the structural adjustment facility (SAF). This material will serve as background to the Board discussion on the enlargement of SAF resources which has now been scheduled for Tuesday, September 15, 1987.

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)

INTERNATIONAL MONETARY FUND

Further Considerations on the Mobilization of Resources in Association with the Structural Adjustment Facility

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

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September 1, 1987

I. Introduction

It has been proposed that the resources available to support policy programs adopted under the Structural Adjustment Facility (SAF) be increased by SDR 6 billion. These resources are intended to be additional to existing commitments that have been made for assistance to SAF-eligible countries. The Heads of State or Government of the G-7 meeting in Venice in June welcomed this proposal and urged a conclusion on discussions aimed at implementing the proposal by the end of this year. It is intended that operations commence by January 1, 1988, with disbursements being made, to the extent possible, over the following three years. 1/

The plight of the Fund's poorer member countries facing protracted balance of payments difficulties that are adopting strong adjustment programs to address their problems is widely recognized. Many of these countries seek continued Fund involvement in their adjustment efforts and continued financial support from the Fund, and calls from creditor and donor countries for the Fund to play a central role in these efforts along with the World Bank have been repeatedly put forward. At the same time, members have stressed the need to maintain the monetary character and financial strength of the Fund. The Fund initiative for an enhancement of the SAF is intended to respond to these requests through the most appropriate means, i.e., through association of additional resources with an existing facility that is well tailored to the need for growth-oriented structural reform in these economies and through funding arrangements that would safeguard the monetary character of the Fund.

A paper was circulated to the Executive Board on June 12, 1987 which briefly outlined proposals for the financial arrangements that

1/ The disbursement period would depend, inter alia, on any final date that may be established for approval of loans to members and on the phasing of disbursements.

could support the enlargement of SAF-related lending. ^{1/} Subsequently, extensive discussions have been held with some potential contributors with a view to soliciting their reactions to the proposed modalities and seeking their guidance on financial arrangements that would best suit their needs and those of the Fund. During these discussions, the proposed financial arrangements have been described in somewhat greater detail. Under these original proposals, the resources to support enlarged SAF-related lending would be channeled through a trust account administered by the Fund. The Trust was seen as capable of accommodating different types of contributions (loans at different interest rates or grants); of facilitating participation under the diverse institutional arrangements of members; of allowing consideration of varying rates of access to the enhanced resources by SAF countries facing widely differing financing requirements; and of operating separately from the General Resources Account (GRA), thereby avoiding questions involving eligibility and access policy that would arise were the funding to be undertaken through the GRA.

In the course of the discussions that have taken place, however, several potential contributors have expressed reservations about the type of trust arrangement that was proposed. Some potential creditors, in particular those that are contemplating loans by their monetary authorities, have expressed concern that claims on the Trust would be subject to risk of nonrepayment and might not be readily transferable or encashable in case of balance of payments need. Moreover, for some potential creditor countries, budgetary, political, or legislative obstacles would need to be overcome. In some countries, for example, existing legal provisions may permit lending for Fund-related purposes to be directed only to the GRA, at least insofar as the lending is from official reserves.

In light of these concerns, some potential contributors have suggested that alternative funding arrangements be given further consideration. The most frequently mentioned alternative would involve financing through the GRA, either through concessional loans or loans at market-related interest rates combined with provision of a grant (through a separate trust account) to fund subsidies to reduce effective charges on such resources to SAF terms (0.5 percent per annum). Other alternatives suggested included selling gold or a "conditional" allocation of SDRs.

This paper discusses the implications of some of these alternatives for the interests of the Fund and its membership. In answer to the requests made by a number of potential contributors, the paper also considers various ways in which claims on the proposed Trust could be protected against risk and provided with an appropriate degree of

^{1/} See "Mobilization of Resources in Association with the Structural Adjustment Facility--Financial Arrangements" (EBS/87/129).

liquidity. Arrangements for the financing of a subsidy account that might be necessary if loans to a Trust are made at, or near, market rates are also considered briefly.

II. Funding Arrangements Suggested by Potential Contributors

1. Lending to the GRA

Several potential contributors have stressed the advantages they would see in lending to the GRA, in particular that such lending would provide creditors with a risk-free and liquid claim, thereby enabling them to provide resources held as foreign exchange reserves by central banks or by exchange stabilization/equalization accounts. It was noted by some that the utilization of such resources might permit contributions to be provided more quickly and without some of the complications that could occur with funding from budgetary sources, although this would not be the case for all potential contributors. Some also suggested that the present liquidity of the GRA might reduce the amount of additional borrowing required to fund the targeted increase in SAF-related lending.

Lending to the GRA would indeed provide the security and liquidity sought by some participants contemplating loans from international reserves to fund an enhancement of SAF-related lending. At the same time, the use of loans to the GRA would have a number of implications for the policies and operations of the Fund.

The Fund's Articles of Agreement do not permit access to the GRA to be restricted to a group of countries defined on the basis of per capita income or on the basis of a list of specific countries, such as the SAF-eligible countries, since this would exclude potential access by the rest of the Fund's membership. The Fund is a cooperative institution that makes available its general resources to all members (Article I(v)). Distinctions may be made by the Fund, in the use of its general resources, on the basis of particular balance of payments problems, but no discrimination can be made among member countries, e.g., between developed and developing countries. The only provision in the Articles that provides for use of the Fund's resources for a limited group of countries is Article V, Section 12(f)(ii), which applies exclusively to the Special Disbursement Account. In this case, however, the Fund is authorized only to use resources in the Special Disbursement Account that are derived from the profit resulting from a gold sale in excess of the amount of the proceeds of the sale that have to be placed to the General Resources Account, i.e., the profit above the amount equivalent at the time of the sale to one special drawing right per 0.888671 gram of fine gold. The amount placed to the General Resources Account is for use by all members without any discrimination.

In considering this issue, some potential participants have asked whether the Compensatory Financing Facility (CFF), the Extended Fund

Facility (EFF), or the operations of the General Arrangements to Borrow prior to December 1983 do not provide precedents for confining specific uses of the GRA to particular groups of Fund members. With respect to the CFF and the EFF, the decisions establishing these facilities indicate that they are likely to be of particular benefit to primary exporters and developing countries, respectively, but do not exclude any member from potential access to the facilities. The indications have no legally binding character. ^{1/} With respect to the GAB, its provisions prior to the general revision in December 1983 permitted its activation only to assist the Fund in financing purchases by GAB participants. However, participation in the GAB did (and does) not confer on participants any entitlement to access to Fund resources beyond or different from that available to other members; the purpose of the GAB is to supplement the resources available to the Fund in particular circumstances, but not to confer rights to use the Fund's resources on any member or group of members on a non-uniform basis. Policies governing access to the Fund's general resources remain the same for GAB participants as for other Fund members. In sum, these various facilities and arrangements do not provide precedents for access to the Fund's general resources on a discriminatory or non-uniform basis.

The CFF and EFF do, however, include criteria for access, related to the nature of members' balance of payments difficulties, that are expected to be of particular relevance to certain broad groups of countries. Criteria for access to a new facility could similarly be established, but they would also have to be based on particular circumstances that result in balance of payments difficulties. While criteria might be found that applied reasonably to many of the SAF-eligible countries and a new special facility created on this basis, a number of these countries might be effectively excluded. At the same time, countries not presently eligible for SAF resources could be captured by the new criteria, and it would be for consideration whether such members would have to be asked to refrain voluntarily from use of the new facility; any understanding on use could not, however, take a legally binding form. In addition, over time, it is possible that the criteria would embrace a changing group of countries.

The financing needs of some SAF-eligible countries that adopt appropriately strong adjustment programs are potentially quite large, in some cases amounting to several multiples of their Fund quotas over the period of the SAF enhancement. If resources for the enhancement of SAF-

^{1/} See Decision No. 6224-(79/135) on the CFF and No. 4377-(74/114) on the EFF. The formulation of paragraph I(i) of the decision on the EFF provides an illustration of this approach. It reads: "The Executive Directors have been considering the establishment of an extended facility for members that would enable the Fund to give medium-term assistance in the special circumstances of balance of payments difficulty that are indicated in this decision. The facility, in its formulation and administration, is likely to be beneficial for developing countries in particular." (emphasis added)

related lending were to be made available through the GRA, a number of these countries would have to be provided access to these resources in excess of that indicated by the Fund's current access guidelines and limits if SAF-related lending were to make a substantial contribution to the projected financing requirements of those countries. To assure uniformity of treatment of all member countries, such a modification of access would have to apply to all member countries that met the established criteria, including any non-SAF countries, and it is possible that aggregate use could be in excess of the total amounts contemplated for the SAF enhancement. At the same time, any change in access policies that led to a substantial increase in drawings from the GRA would have to be considered carefully in an effort to avoid inconsistencies with the intentions to phase out enlarged access and to limit the prolonged use of Fund resources.

Substantial use of resources provided through the GRA for funding enhanced SAF-related lending would have other important implications for the Fund's financial position. It would involve expanded access to the GRA by a number of countries whose use of Fund resources is already high and in some cases prolonged, thereby further increasing and lengthening the Fund's exposure to some of those countries, with implications for the revolving character of the Fund's resources. In addition, lending to the GRA and use of its resources for this purpose might give rise to liquidity problems for the Fund, especially if significant use of the new facility were made by non-SAF countries, the maturities of borrowings by the GRA did not fully match the maturities of its lending on SAF terms, or there were substantial encashments of loans to the GRA.

If the substantial financial assistance required by some SAF-eligible countries to support the kind of meaningful adjustment policies that are necessary to restore growth and to promise substantial progress toward external viability were to be provided through the GRA, the role of the SAF itself may be diminished. The SAF was created as a distinct facility within the Fund targeted to a specific group of countries and well tailored to the adjustment needs of those countries. It carries with it as well a specific and rapidly developing form of collaboration between the Fund and the Bank--reflected most prominently in the Policy Framework Paper (PFP)--which is unique to the SAF. Any diminution of its role at this stage would surely be unfortunate.

On balance, making substantial additional resources available to some SAF-eligible countries through the GRA would seem to raise a series of interrelated problems that could have adverse implications for the Fund's policies and monetary character, as well as for the continued development of the SAF itself. Recognizing these potential problems, some prospective participants have asked whether there is not some way in which the GRA could guarantee the operations of a trust, or whether the characteristics of claims on a trust could be strengthened by other means, so as to obtain the advantages of a trust approach while at the same time providing security and liquidity along the lines associated

with lending to the GRA. These questions are explored in Section III below.

2. Sale of gold

A number of potential contributors have also raised the possibility of sales of Fund gold to fund additional financing for SAF-eligible countries. At this stage, the various proposals have not been fully articulated and might take a variety of different forms--not all of which would necessarily prove acceptable to those that have indicated some willingness to consider possible gold sales. For example, under some possible formulations, gold sales might be relatively small, designed only to "top up" any marginal shortfalls in loan commitments by lenders or, alternatively, in the amount of grants received for the intended interest subsidization. Under others, required sales might be very large. Sales to fund the entire SDR 6 billion in enhanced SAF lending would, as an illustration based on recent market prices and exchange rates, require sales of nearly 20 million ounces, or roughly 1/5 of the Fund's gold holdings. Such undertakings by the Fund could place the Fund's gold holdings at substantial risk regarding changes in prices and market conditions, and could themselves adversely influence market conditions with consequences for the holdings of members as well.

More fundamentally, the Fund's gold holdings are an essential element in its financial strength and, in the present world economic environment, it is important that this strength be maintained. Gold serves not only to underpin the Fund's current operations and financial position, but also to enhance its ability to respond to unexpected developments of a systemic nature. Moreover, the Fund's gold holdings could be of particular relevance to members in considering future increases in the resources of the Fund whether through quota increases or borrowing.

3. "Conditional" SDR allocation

Another funding mechanism that has been suggested would involve an allocation of SDRs and the onlending of these SDRs by contributing countries back to the GRA. ^{1/} It would be difficult to elaborate on a solution premised on an allocation of SDRs at this time, as recent discussions continue to suggest that the majorities required are not present; the introduction of such a scheme would not obviate the requirements of the Articles of Agreement for an allocation of SDRs. Additionally, while this proposal, like lending to the GRA and gold sales, might generate additional resources for lending by the Fund, it would raise the same complex of issues regarding access policy, eligibility, and the financial position of the Fund as lending to the GRA, discussed above. Moreover, in the case of some potential contributors,

^{1/} Technically, contributing countries would lend currencies to the GRA which would be used simultaneously to purchase SDRs from the lenders.

implementation of the scheme would require legislative and budgetary approval.

III. A "Protected" Trust Arrangement

The question has been raised by several potential contributors whether there are ways to provide claims on a Trust with the main features of lending to the GRA, without raising the complications for Fund policies that placing the operation in the GRA would imply. A variety of questions and suggestions have been put forward with the objective of enhancing the security and liquidity characteristics of financing the enhancement of SAF-related lending through a Trust. It is clear that funding the enhanced SAF through a trust arrangement need not involve assumption of the entire risk by the lender nor give rise to an illiquid claim. This section first discusses questions that have been raised regarding the possibility of some form of "guarantee" by the GRA, and then describes a number of alternatives that could be considered in order to give increasing assurance to creditors regarding the security and liquidity of their claims; some of these alternatives could be combined in an agreed fashion.

It needs to be stressed that while the concerns of some lenders with the question of risk may be understandable, the discussion below and the effort to provide more tangible security in no sense imply that there will be any less attention paid to the strength of the adjustment programs to be supported by SAF-related resources. In the end, the best protection for potential creditors lies in the strength and appropriateness of the adjustment programs those resources would support. It is indeed the intention of management to propose that in administering the enhanced SAF the Fund should reinforce its policies so as to improve the quality of SAF loans. In this connection, a paper which considers the implications of enlarging SAF-related lending for the monitoring of SAF arrangements will soon be circulated to the Executive Board.

1. The question of "guarantees" by the GRA

A number of potential contributors have asked whether it is not possible for the resources of the GRA to be used in some fashion to guarantee the financing that would be provided in the framework of a Trust. Possibilities suggested have included a direct guarantee by the GRA of borrowers' obligations to the Trust or of the Trust's obligations to lenders; a borrowing by the GRA and onlending of the proceeds to the Trust; and an undertaking by the Fund to provide a borrower with access to the GRA if necessary to help fund a payment by the borrower to the Trust.

These suggestions are examined below.

a. Direct guarantees

Article V, Section 2(a), defines and limits the possible activities of the Fund. It reads as follows:

"Except as otherwise provided in this Agreement, transactions on the account of the Fund shall be limited to transactions for the purpose of supplying a member, on the initiative of such member, with special drawing rights or the currencies of other members from the general resources of the Fund, which shall be held in the General Resources Account, in exchange for the currency of the member desiring to make the purchase."

Contrary to the World Bank, the Fund has no power under its Articles to extend a guarantee. A guarantee for the Trust could ultimately lead to a transfer of resources from the General Resources Account to the Trust in compensation for the failure of the Trust to be repaid by debtors. Such a transfer is not authorized under the Articles, and would not be a transaction in accordance with Article V, Section 2(a).

b. Borrowing

Article VII, Section 1, defines the Fund's power to borrow. It reads as follows:

"The Fund may, if it deems such action appropriate to replenish its holdings of any member's currency in the General Resources Account needed in connection with its transactions, take either or both of the following steps:

(i) propose to the member that, on terms and conditions agreed between the Fund and the member, the latter lend its currency to the Fund or that, with the concurrence of the member, the Fund borrow such currency from some other source either within or outside the territories of the member, but no member shall be under any obligation to make such loans to the Fund or to concur in the borrowing of its currency by the Fund from any other sources;" (emphasis added).

The Fund may borrow only to replenish its holdings of members' currencies in the GRA needed in connection with GRA transactions. It has no authority to borrow on its account for a trust (or the SDA), nor to transfer the proceeds of borrowings to a trust (or the SDA). Neither would be a transaction of the General Resources Account, as defined and limited by Article V, Section 2(a).

c. Access for SAF borrowers

The GRA could not undertake to provide access to its general resources for any SAF borrower in order to enable the borrower to meet its obligations to the Trust. A special facility for this purpose would be inconsistent with the requirement of the uniformity of treatment of members, as the only potential users of the facility would be confined to the SAF-eligible countries, to the exclusion of the rest of the membership. Moreover, the Fund could not provide access to the resources of the GRA to a member in the absence of adequate safeguards (e.g., an adjustment program) for the temporary use of these resources (Article V, Section 3(a)), and would not be in a position to compel a member to adopt or provide such safeguards (or, indeed, to make use of the Fund's general resources).

Article V, Section 3(a), reads as follows:

"The Fund shall adopt policies on the use of its general resources, including policies on stand-by or similar arrangements, and may adopt special policies for special balance of payments problems, that will assist members to solve their balance of payments problems in a manner consistent with the provisions of this Agreement and that will establish adequate safeguards for the temporary use of the general resources of the Fund."

While a SAF borrower would always have the ability to make use of the Fund's general resources subject to the Fund's policies regarding access and safeguards that are applicable at the time, and to use the proceeds of any purchase from the GRA in satisfaction of obligations to the Trust, it would not seem that this possibility would provide potential lenders to the Trust with firm assurances regarding the security of their claims.

2. Possible steps to strengthen the security and liquidity of claims on the Trust

a. Security

(1) Subordination of the claims of the Special Disbursement Account (SDA) to claims of the Trust

Under an enhanced SAF financed through a trust arrangement, the Fund could make available resources from the Trust simultaneously with loans from the SDA, with the consequence that payment of interest and repayments with respect to SAF loans and to Trust loans would generally be simultaneous. The Fund could decide, in the event a member using the SDA and Trust resources made insufficient repayments to discharge obligations with respect to both, to subordinate repayments with respect to the SDA to those of the Trust. In other words, the obligations of a member country to the Trust would be discharged prior to the discharge of its obligations to the SDA.

(2) Assurance

The Fund could also decide, beyond any subordination of SDA claims, that any resources flowing to the SDA from the repayment of or interest on SAF loans could be made available to pay any obligations of the Trust as and when they fell due in the event that the Trust itself had not been paid by a user of the Trust's resources. The ability to assure creditors in this way would, of course, be limited by the amount of resources actually held in the SDA at any time.

(3) Establishment of a reserve in the Trust

The Fund could decide to establish a reserve in the Trust, and the reserve could be available as needed to help meet the liabilities of the Trust. A reserve for the Trust could be financed over time from resources derived other than from contributions, including the use in one form or another of available yet uncommitted resources in the SDA.

Resources to establish a reserve in the Trust could derive from the following sources:

(a) The interest income earned from the investment of the resources held in the SDA, pending disbursement in support of SAF arrangements, could be redirected to the new Trust arrangement and invested on behalf of the Trust. At present rates of return it is estimated that approximately SDR 150 million could be built up by 1990 on the assumption that all resources available to the SAF have been fully disbursed by then.

(b) The interest earned on outstanding SAF loans could also be directed to the Trust, after allowing for administrative expenditures. Assuming full payment of interest on SAF loans and investment at market rates of accumulated balances deriving from such interest, on the order of an additional SDR 100 million could be built up over the life of the Trust.

(c) Income from a surcharge on loans extended by the Trust could be added to the reserve. This surcharge, which at, say, 0.2 percent per annum is estimated to amount to about SDR 100 million during the life of the Trust, could be refunded to the borrowers on the liquidation of the Trust.

The amounts indicated in (a)-(c) could provide assurance against possible delays in interest payments by the debtors which would affect the ability of the Trust to meet its obligations as they fall due. The flow of resources to the reserve from interest income and its investment could start from the date of the establishment of the reserve and would be available to guarantee the unsubsidized portion of interest

payments by the Trust which would be of the order of SDR 30 million a year at a maximum. 1/

(d) A further way to finance a reserve to secure the obligations of the Trust would be to direct a portion of the principal repayments on SAF loans to the Trust. These proceeds could be held in the reserve pending the liquidation of contributors' claims on the Trust. The maximum prospective reflows from SAF loans, together with the investment income earned on the proceeds of repayments, could amount to approximately SDR 4 billion over the period 1991-2000. 2/ The use of the proceeds from the repayment of SAF loans would, of course, effectively preempt the resources that would otherwise have been held in the SDA and would temporarily preclude using them for other purposes.

(e) In addition, consideration could be given to techniques by which participants collectively could help to ensure the security of claims on the Trust. For example, a discount of, say, 0.2 percent per annum on loans to the Trust (paralleling the surcharge suggested in (c) above) could generate additional amounts for the reserve, estimated to amount to about SDR 100 million over the life of the Trust, which could be refunded to lenders on liquidation of the Trust. 3/

(f) As a somewhat different approach, which could be combined with some of the proposals above, the establishment of a sinking fund arrangement could also be considered. Under such an arrangement, a portion of the loans outstanding, say, 2.5 percent, would be repaid by debtors to the Trust into the reserve each year. These sinking fund payments would stop once the usual repayments begin (after 5 1/2 years). This would, in fact, represent a modification of the envisaged schedule for repayments to the Trust, eliminating, in effect, the initial five-year grace period that applies to loans provided under the SAF. Possible advantages would be that the payments required in any year would be small and would take place in close proximity to the members' adjustment efforts under their SAF programs; and that this technique would somewhat accelerate the accumulation of the reserve.

1/ This could fully protect the creditors of the Trust over the first 5 1/2 years (through mid-1993) when only interest payments would be due from the Trust.

2/ At present rates of interest, it is estimated that about SDR 200 million would be available from this source in the Trust's reserve in late 1993 (when the first repayments to creditors would fall due, assuming disbursements under the enhanced facility begin in early 1988), and that this amount would increase rapidly, rising to about SDR 4 billion when the last repayments to creditors would fall due.

3/ Participants could also consider making available to the reserve, also on a refundable basis, a portion of the remuneration received on their reserve tranche positions during the life of the Trust. Such transfers to the reserve would be voluntary and might for some participants require legislation and/or budgetary action.

These sources of funds could, in various combinations, provide a flow of resources to a reserve of the order of SDR 4 1/2 billion over the life of the Trust, on the assumption that all obligations to the SDA are met and the proceeds of these payments on SAF loans are held in the reserve. The amounts available in the reserve would be relatively small at the outset. However, they would be adequate to cover any delays in interest payments and would not be needed for use in covering possible delays on principal repayments on loans by the Trust until late 1993, by which time reflows from earlier SAF loans would begin to build. As noted, the reserve could build to approximately SDR 4 1/2 billion at a maximum, which is very large in relation both to the size of the Trust's operations and obligations and to any indicators of risk of late payments that might be suggested on the basis of the Fund's own experience to date. It may be noted in this connection that of the nearly SDR 1.7 billion in Trust Fund obligations that have fallen due in the period July 1982 1/ to date, which has represented a period of extreme difficulty for many borrowers, only somewhat less than SDR 100 million, or 5.8 percent of the total, has not yet been paid.

Moreover, if, as seems likely, some potential participants choose to make their contributions in the form of parallel bilateral loans, 2/ the proportion of the Trust's obligations that would be covered by the reserve would be correspondingly greater. Indeed, it would seem questionable whether such a relatively large reserve would be needed to secure the creditworthiness of the Trust. If the extreme assumption were made that borrowers would ultimately default on, say, one-third of their obligation to both the SDA and the Trust, the amounts that could be accumulated in the reserve would still be far in excess of amounts needed to cover the unpaid obligations to the Trust. 3/ Moreover, the obligations of the Trust would peak in the early 1990s and decline over the remainder of the decade, while the reserve would continue to increase. It is projected that the amount in the reserve would begin to exceed the remaining obligations of the Trust roughly midway through the last half of the decade. At that point, it would be possible to cease further reserve accumulations and begin to release funds from the reserve, for reversion to their various sources, including for subsequent use by the SDA.

Additional protection might be extended, in cases where the creditor concerned is a governmental agency or central bank, by provision of a guarantee from the creditor's own government. Other means to enhance the quality of claims on the Trust could be considered by using

1/ I.e., since Trust Fund repayments began.

2/ It will be recalled that the possibility of this form of participation was mentioned in EBS/87/129.

3/ This illustration assumes that all lending is to the Trust (i.e., the entire SDR 6 billion being sought is provided in the form of loans to a Trust and that there is no participation through bilateral parallel lending) and assumes that the protective elements of the reserve materialize as discussed above.

the leverage of the Fund itself. For example, it has already been decided as part of the Fund's policies regarding overdue obligations not to permit members in arrears to the Fund to use the Fund's resources. The possibility that overdue obligations to the Trust could impede access to other Fund-related resources would provide added reasons for borrowers to remain current with the Trust.

(4) Possibilities for protection against risk
beyond establishment of a reserve in the Trust

The various sources of funds listed above that could be made available for protection of the Trust should, in substance, provide a very large measure of protection against risks of nonpayment of the obligations of the Trust. They also would provide a source of liquidity for claims on the Trust, discussed further below. While some risk of less than full repayment would remain, such losses would seem possible only in the context of major systemic difficulties and the need to mobilize resources to protect creditors from such losses would appear extremely remote. Nevertheless, even the remote possibility of loss could pose difficulties for some potential participants. In this context, some additional suggestions have been put forward for consideration, as possible sources of protection to which recourse might be made only as a "last resort" after all other available sources as listed above had been exhausted.

One suggestion that has been made is that the Fund and members agree that, if necessary to enable the Trust to meet its obligations, the Fund would distribute some portion or all of its general reserve and the recipients would, in turn, transfer the proceeds of this distribution to the Trust. Such a decision by the Fund would require a 70 per cent majority of the total voting power. The transfer of the proceeds to the Trust, which would be essential to achieve the purpose of the operation, would be voluntary and would require the cooperation of all Fund members, as the distribution of reserves would be made to all members in proportion to their quotas. The general reserve currently amounts to SDR 366 million. 1/

In considering this suggestion, it would be necessary to weigh a number of factors, including the role of the Fund's reserves and the efforts that are currently being made to strengthen the Fund's financial position, including through faster accumulation of reserves; the potential contribution such an action might make toward progress on the proposed SAF enhancement; and the likelihood that a need would arise for actual implementation of a distribution. Account would also need to be taken of the possibility that, for some members, agreement to make the proceeds of the distribution available to the Trust (or in any case to actually make the transfer) might require legislative and/or budgetary action.

1/ Distribution of the Fund's special reserve is precluded under Article XII, Section 6(b).

Beyond these measures, some potential contributors have asked that a further mechanism be found to fully ensure the integrity of all claims on the Trust. If it becomes necessary to provide these further assurances, the Fund could stand ready to consider sympathetically at the time of liquidation of the Trust whatever additional initiatives may be necessary and appropriate to effect full repayment by the Trust to all creditors. It needs to be reiterated, however, that the likelihood that such a need would arise would appear extremely remote and of potential significance only in the event of the most severe world economic conditions.

b. Liquidity

There are also a number of ways in which account could be taken of a participant's balance of payments situation and the liquidity of claims on a protected trust could be enhanced. 1/

(1) Claims on the Trust could be made transferable to other participants, members or other official entities on a voluntary basis.

(2) Provision could be made to suspend temporarily calls on a participant's commitment to the Trust in the event of a balance of payments need. This would imply disproportionately large drawdowns on others' commitments during the suspension and, if the suspension persisted, ultimately a reduction in the amounts available for lending by the Trust. It would be expected that a participant would resume lending under its commitment as soon as its balance of payments permitted, and that subsequent calls would be arranged so as to restore broad proportionality in use of participants' commitments over time.

(3) Holders of claims on the Trust could be permitted to request encashment of their claims in case of balance of payments need, for which purpose amounts available in the reserve (or some portion) could be used. It would be expected that such encashments would be reversed promptly, as soon as the balance of payments of the holder permitted. In order to preserve the availability of the reserve and thus the scope for meeting such requests for encashment should they become unavoidable, it would be desirable if participants collectively were to agree that they would first draw on any available reserve tranche position in the Fund before seeking encashment of claims on the Trust.

1/ As noted, some lenders may participate on a bilateral basis outside the Trust. Others may finance their lending to the Trust through institutional arrangements under which liquidity is not an important consideration. Both of these approaches would tend to facilitate the provision of liquidity for the remaining participants that attach importance to this characteristic of their claims on the Trust.

(4) The liquidity of claims on the Trust could be considerably enhanced if participants (or those participants that are most concerned about the liquidity of their claims) were to agree mutually, at the outset, that they would be prepared either to purchase the claim of a participant (or of a participant in this group) representing a balance of payments need or to advance to the Trust amounts needed, in excess of any available reserve, to enable it to meet requests for encashment on grounds of balance of payments need. The latter type of undertaking would be comparable in principle to the encashment provisions of the General Arrangements to Borrow. Such mutual undertakings would need to be limited and shared in some agreed fashion, and it would be expected that transfers or encashments under such arrangements would be reversed in a relatively short period of time. However, if participants' undertakings were limited to the amount of their commitments to the Trust, such arrangements could provide a substantial source of liquidity only for a relatively brief period of time, i.e., only until the commitments were fully drawn. It would therefore be preferable if participants' undertakings extended beyond the level of their commitments to the Trust.

(5) Finally, if arrangements along the lines suggested above were not considered to provide adequate liquidity, it would be possible for the Fund's GRA to assist in the mobilization of foreign exchange resources equivalent to the outstanding amount of claims on the Trust held by a member. This approach would involve the establishment of a special "mobilization facility," under which the Fund would stand ready to provide access to its general resources for any member country, beyond any available reserve tranche position up to the amount of its claims on the Trust, representing a liquidity need for those resources as a consequence of its holdings of a claim on the Trust that cannot be otherwise mobilized.

A number of important questions would need to be considered:

(a) A member is entitled to purchase from the GRA "if it represents that it has a need to make the purchase because of its balance of payments or its reserve position or developments in its reserves" (Article V, Section 3(b)(ii)). Liquidity developments in the member's reserves, therefore, can provide a justification for such a purchase even without a balance of payments need. However, the criteria for the determination of a liquidity problem, as distinct from a balance of payments problem, would need to be clearly defined.

(b) Adequate criteria for access to a mobilization facility that take into account the need for uniform treatment would have to be developed.

(c) Since repurchases may involve repurchase periods longer than those prescribed under Article V, Section 7(c), an 85 percent majority for the establishment of such a facility would be required (Article V,

Section 7(d)). It should also be noted that the member may be subject to charges under Article V, Section 8.

(d) The Fund would, in any event, have to require adequate safeguards for the temporary use of its resources (Article I(v)). It would have to be examined whether and under what circumstances a claim on the Trust could constitute an adequate safeguard.

(e) The member would be expected to repurchase as soon as its reserve position permitted, and would be obligated to repurchase upon sale of the claim, or its payment by the Trust, or within a specified period, whichever comes first.

IV. Interest Subsidy Account

Irrespective of the manner in which the enhanced SAF is financed, interest payments on any loans extended by creditors at rates above the 0.5 percent rate on the proposed loans to SAF-eligible countries would have to be subsidized if SAF terms are to be maintained. The most practical means of funding the necessary subsidy would be in the form of grant contributions, which would be deposited into an interest subsidy account, administered as a trust by the Fund. Were these grants to be provided in full at the time operations commenced, then the amount necessary to subsidize SDR 6 billion in loans extended at, say, a 5 1/2 percent rate of interest would be a little under SDR 1.7 billion. ^{1/} However, the entire subsidy would not need to be provided all at once. For example, were subsidy contributions to be spread over a five-year period, the amount of grants needed each year would be considerably smaller, averaging about SDR 385 million per year, although the total of grants required would be somewhat larger. These calculations are obviously sensitive to assumptions made regarding interest rates (and the pace of disbursements); were the borrowing rate to be increased by one percentage point to 6 1/2 percent, for example, then the average annual grant contribution required over a five-year period would rise to about SDR 450 million. For this reason, it might be desirable if grant commitments were reviewed on a periodic basis, perhaps every three years. Creditors will, of course, have the option of extending loans at less than market interest rates. In such circumstances, the subsidy, and therefore grant contributions, needed would be correspondingly less.

^{1/} This assumes that such balances would be invested pending their use to subsidize interest payments over the life of the enhanced SAF arrangements.

V. Summary

This paper has been prepared in light of initial discussions with some potential contributors regarding the possible financial arrangements that could be used in support of the proposed enlargement of SAF-related lending. Officials of several of these countries have expressed reservations about the type of Trust arrangement that was initially put forward by the staff, citing in particular concerns that their claims on the Trust would be subject to risk of nonrepayment and would not be of a liquid nature, encashable or transferable in case of balance of payments need. As possible alternatives, several potential contributors have suggested that lending instead be directed to the Fund's General Resources Account (GRA); that Fund gold be sold in support of the expansion of SAF-related lending; or consideration of a "conditional" SDR allocation, which would involve, in effect, a lending of allocated SDRs by some recipients to the Fund's GRA. A number of potential contributors have also asked whether there are ways to combine the advantages of an operation through a Trust with steps to provide greater security and liquidity for claims on the Trust.

This paper reviews some of the issues that would arise in channeling the expansion of SAF-related lending through the GRA or in sale of Fund gold to finance expanded SAF lending. It also describes a number of suggestions for ways in which the security and liquidity of participants' claims could be enhanced in the operating framework of a trust arrangement for the expansion of SAF-related lending.

As regards the risk of nonpayment of claims on the Trust, these could involve: (i) subordination of claims of the SDA to claims of the Trust; (ii) assurances that resources flowing to the SDA in payments on its loans would be used to the extent necessary and, as far as possible, to meet the obligations of the Trust; and (iii) establishment of a reserve in the Trust. A reserve could be financed from investment earnings on balances held in the SDA, interest on SAF loans, income from a possible surcharge on loans from the Trust, and, as an alternative to a guarantee from the SDA, from the proceeds of payments of SAF loans. Participants themselves could mutually contribute to the security of the Trust by permitting the Trust to retain in reserve a portion of the interest otherwise payable on its borrowings and by directing to the reserve a portion of their receipts of remuneration, both types of contributions to be refunded upon liquidation of the Trust. Finally, although the above measures should provide important security for claims on the Trust, the paper also mentions additional suggestions that have been advanced for coverage of residual risk relating to possible use of the Fund's general reserve and requests by some potential contributors that the Fund stand ready to consider other means of assuring the integrity of the Trust's obligations should the need ultimately arise.

As regards liquidity provisions, account could be taken of participants' balance of payments difficulties in a number of ways: claims could be made transferable on a voluntary basis; provision could be made

for suspension of calls; and provision could be made for encashment of claims, utilizing balances available in the SDA or in the Trust mentioned above. The availability of these balances could be protected if participants would agree to give priority to use of their reserve tranche positions over such encashment of claims on the Trust. A further important degree of liquidity could be accorded to claims if participants (or those particularly concerned about liquidity) were to agree collectively at the outset that they would be prepared to purchase the claim of a participant (or a participant in this group) representing a balance of payments need, or to advance to the Trust amounts needed to enable it to meet a request for encashment by such a participant. Such a provision would be comparable to encashment provisions of the general Arrangements to Borrow. Finally, consideration could be given to creation of a kind of "mobilization facility" by the Fund which could be of assistance to members having a liquidity need and unable to liquidate claims on the Trust.

Through the various techniques discussed, the Fund could, in effect, absorb a large proportion of the risk involved in the proposed enlargement of SAF-related lending, and substantial liquidity could be provided in connection with the associated claims, while avoiding the difficulties associated with fundamentally different financing techniques.

While this paper has necessarily focused importantly on the question of security, in response to concerns expressed by some potential participants, consideration of the possible risk that may be involved in enlarged SAF-related lending should in no sense be taken to imply that there will be any less attention paid to the strength of the adjustment programs to be supported by SAF-related resources. In the end, the best protection to potential creditors lies in the strength and appropriateness of the adjustment programs those resources would support. In this connection, a paper which considers the implications of enlarging SAF-related lending for the monitoring of SAF arrangements will be circulated to the Executive Board around the time of the Annual Meetings.