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Statement by Mr. Poso and Mr. Damgaard on Fund's Pandemic Response: Options for Lending to Support Members During the Next Stage of the Crisis
(Preliminary)
Executive Board Meeting
September 25, 2020

We thank staff for the comprehensive document on the *Fund's Pandemic Response – Lending Options to Support Members During the Next Stage of the Crisis.* We agree with staff's view on focusing on stabilization and the need to balance between supporting growth and macroeconomic adjustment, when moving from containment to recovery. Overall, we see the need for flexibility in program engagement to manage the uncertain environment, but we do not agree that addressing longer-term challenges should outright be pushed to the uncertain future.

The Fund has responded to the crisis quickly and efficiently, providing emergency and other financing to almost half of its members. **We highlight the importance of similar ambition on the policy side,** as governments are facing unprecedented challenges in finding a path out of the crisis. Instead of weakening the policy response upfront, **Fund programs should focus on policies that improve the conditions for recovery but are designed and sequenced to protect growth and equity**. Thus, program design should not compromise on policy ambition, but it should be ready to offer flexibility if/when conditions change.

Furthermore, we firmly believe that **strong programs with contingency plans and sufficient flexibility, specifically in this challenging situation, underpin and maintain the Fund's catalytic role**.

A general assumption in the document appears to be that the uncertainty created by COVID-19 will end in the near future. This could prove to be too optimistic. We call for the analysis and program design to consider the possibility of a prolonged period of uncertainty. In this context, **we highly support a risk-based approach.**

Furthermore, we think that the recovery **may not be synchronized between countries**, but it will depend on, e.g., the geographical spread of the virus, country characteristics, economic structures, domestic policy actions, and dependency on foreign trade. Hence, we remain to be convinced that a **single solution response can be designed for the next stage of the crisis as the most optimal arrangement will vary between countries.** Instead, a good approach would be to comprehensively utilize the Fund's existing broad lending toolkit and its flexibility.

Debt sustainability issues are likely to be a prevalent challenge as the global shock continues. We missed a broader discussion of this aspect in the paper. Overall, we **call for policies to improve debt sustainability, including debt transparency, debt management capacity, and domestic revenue mobilization to be prioritized in program design** in addition to the proposed supplementary debt-related safeguards.

<u>Lending instruments</u>

In general, we see UCT-quality programs as a key pillar for Fund engagement. The quality of policies should be as important as the financing to strengthen the catalytic effects and economic prospects.

In addition, we missed **a more thorough discussion in the document on the option of using an SBA as a first alternative for countries, where there are no evident structural issues behind the BoP need.** The current framework allows for canceling an on-going arrangement and to apply for a new one, should conditions and underlying challenges prove worse than assumed. This makes it possible to, e.g., start with an SBA and then if assessed necessary change to an EFF. *How would this alternative compare to the pandemic window under the EFF in option 3? We would also ask staff to elaborate on the potential risks of allowing for more flexibility under the current facilities (option 2) and how this could be ring-fenced.*

We are not convinced of the need for a new facility as the current toolkit has the flexibility to adapt to both different country conditions and uncertainty in the external environment. We also remain to be convinced that a new facility would significantly reduce stigma and in this respect note that the latest addition to the Fund's toolkit has yet to be used. Furthermore, creating new instruments could lead to facility proliferation, unnecessary operational costs, and postponement of programs. *Could staff lay out a realistic timetable for developing a pandemic window under the EFF?*

We could, however, be open to consider a pandemic window under the EFF as a compromise, but without the explicit commitment to back-load the formulation of structural polices. *Could staff elaborate on how such a revised pandemic window would differ from the current EFF, and has staff assessed how large the demand for a new facility/window would be? Could staff also elaborate a bit further on the type of countries that would need funding from the new window/facility?*

Further, **we are somewhat worried that a new form of pandemic lending would generally steer financing requests towards an instrument with lighter conditions** than the usual Fund programs, even in cases where "normal arrangements" would be more appropriate. *Does staff see this as a risk? How will the Fund be able to manage moral hazard and navigate those countries with structural problems to lending arrangements other than the pandemic window?*

We disagree with the notion of using communication as a rationale for establishing a new facility. Good communication could also be that the Fund has a well-established toolkit for a crisis. This should not be a negative thing as long as the Fund can meet the needs of the membership.

The described challenges that member countries are facing are particularly serious in many LICs, most of which primarily access Fund lending through the PRGT. To be fully able to take into account the challenges arising in the LIC context together with ensuring sustainable access to concessional funding, we agree with staff that **options for adapting these proposed policies for PRGT lending are best placed to be discussed as part of the ongoing review of concessional lending**.

Program modalities

Gradual approach: We do not support an upfront weakening of program design as this could lead to unnecessary delays and weaken recovery. However, we see merit in designing polices to fit the current situation with contingency plans and flexibility. The Fund should support the membership with policy advice that improves the conditions for recovery, but also be flexible to the changing environment.

Longer repurchase: The magnitude and uncertainty related to the current shock may compromise the capacity to repay the Fund within the expected repayment period of an SBA in some countries. However, we do not think that this is the case for all countries as recovery is likely to be heterogeneous. There is already flexibility in the current framework to change an SBA to an EFF with a longer repayment period, should external or internal conditions prove worse than initially assumed. Furthermore, we see a risk that a general approach of directing funding toward longer repurchases could compromise the principle of the revolving nature of Fund resources.

Phasing: Frontloading with limited program strength is problematic, as per very recent evidence. A strong program is the best assurance for catalyzing financing. We should not compromise on this. Promoting the catalytic role requires a credible program and solid measures to ensure debt sustainability and ability to repay the Fund.

Program reviews: Flexibility in program design requires a strong and continuous policy dialog between staff and country authorities to ensure the program stays on track and the policy program is adjusted if conditions change. We support more frequent program reviews and finding a good balance between not overburdening the authorities while supporting them in responding to the evolving situation.

State-contingent financing: We do not believe that this is necessary. If conditions change and the country meets the relevant requirements, it can ask for an augmentation under the current framework. Planning for an augmentation from the onset will just create an expectation of one. We support using the opportunity to cancel the arrangement or change it to a precautionary arrangement if conditions improve. *What is the added benefit from state-contingent financing compared to the existing ability to augment or cancel an arrangement?*

Contingency planning: Risk-/scenario-based contingency planning seems very appropriate considering the prevailing uncertainty. We would advocate for a stronger program from the onset with flexibility and contingency plans to adjust policy to different scenarios.

Review centric monitoring of quantitative conditionality: We understand the challenges related to setting QPCs in the current environment. Applying a more review-centric approach with greater use of Indicative Targets can thus overall be accepted as a short-term option to address the exceptionally high uncertainty but should be well motivated in each case. We encourage defining some critical QPCs on certain variables (e.g., level of reserves, fiscal balance, arrears), while we agree that for some variables ITs are better suited with the current high degree of uncertainty.

Broad menu of policy options: The Fund should provide cross-country analysis and best practices for crisis response to the membership. Reverting to unconventional policies may be warranted in individual cases, but the cases should be parsimonious and time-limited to address the specific unusual economic and sectoral impacts of the pandemic. Policies should be in line with Fund policy guidelines (e.g., IV) and the possible longer-term implications carefully considered. Notably, governance and transparency aspects should not be compromised to ensure scarce resources are directed effectively.

Safeguards

We thank Staff for proposing additional safeguards, which touch upon important risks inherent in the current environment. However, the implementation remains somewhat unclear. *Could staff clarify how they will be implemented? Does staff envision these measures to be obligatory for all program engagement during the pandemic?*

On specific proposals:

- **We support a general approach of normal access** but stress that access levels should continue to be based on staff's assessment of the BoP need and the member's ability to repay.
- **We strongly support enhanced debt monitoring**, including having more frequent DSAs and high frequency of reviews when debt is not sustainable with

high probability. This should be complemented by program policies supporting debt sustainability.

- **We support incentives for early re-profiling when debt sustainability is questioned.** We find the proposed safeguards of applying EA criterion 2 to normal programs and the two-step approach very interesting options. *Could staff elaborate their views on the practical implementation of these proposals?*