

The New Roles and Facilities of the World Bank

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The international debt problem has been an evolving phenomenon, involving a number of actors. A constructive approach to the matter requires a positive response from all the actors, in a cooperative effort. The IMF's role in tackling the international debt problem must therefore be viewed as a central element in a wider international strategy to address the issues involved.

During 1989 the focus shifted somewhat from an approach relying mainly upon debt rescheduling, to one including possible debt and debt service reduction in support of adjustment. In this process of debt workout, there are four parties responsible for generating a cooperative approach to the problem: the creditor countries, the indebted countries, the commercial banks, and the international finance institutions. Each one has a specific role to play in the process.

First, there are the governments of the creditor countries. Their role is three-fold. They must adopt policies to achieve 'maximum sustainable high quality growth',¹ and to reduce trade protectionism. Additionally, there is a need for them to provide appropriate financing, both multilateral and bilateral, and relief initiatives (as formulated at the Toronto summit) for official debt.

Second, the over-indebted countries bear a responsibility to pursue strong growth-oriented adjustment policies, and to negotiate and fulfil the terms of appropriate financing or debt restructuring arrangements with creditors and donors.

Third, there are the commercial banks. Their responsibility includes rescheduling debt, and agreeing to debt and debt service reduction where appropriate. However, they should continue lending in moderate amounts to countries which are embarking on, or already making steady progress on, serious adjustment programmes.

Fourth, there is the role of the international financial institutions, and in particular, the Fund's specific responsibilities. These are to provide sound policy

* Portions of this article have appeared in publications of the International Monetary Fund.

¹ Opening Address by the Managing Director of the International Monetary Fund at the Annual Meeting of the World Bank and International Monetary Fund, September 26, 1989. *IMF Survey*, vol 18, no 19, p.294.

advice, and to play a part in financing, by making resources available to any member correcting its balance of payments difficulties, within prescribed limits and subject to conditionality. There is also the important catalytic effect which support from the Fund can have, and the Fund's ongoing collaboration with the World Bank. By contributing in these ways, the Fund can further strengthen the international debt strategy.

The Operation of the International Monetary Fund

The prime functions of the Fund are to provide the machinery for advice and collaboration on international monetary problems; to supervise the overall functioning of the international monetary system, by promoting a proper balance between adjustment and financing in all member countries; and to make resources available to members, in order to support the measures they are taking to correct temporary maladjustments in their balance of payments.

Each member country is assigned a quota in relation to its economic strength. The size of the quota determines the member's voting powers and the amount of foreign exchange or SDRs which it can 'purchase' from the Fund as well as its financial contribution to the Fund. Special Drawing Rights (SDRs) are allocated to members in proportion to their quotas. SDRs have become accepted reserve assets and can be exchanged for convertible currencies from other members, but require payment of interest. The calculation of the value of SDRs is made daily on the basis of a basket of currencies of the USA, the UK, the Federal Republic of Germany, France and Japan.

The drawings of funds to support balance of payments adjustment are limited by provisions which govern the total amount of the Fund's holdings of the member's currency, expressed as a percentage of its quota. Those purchases that do not bring the Fund's holdings of the member's currency above its quota, known as reserve tranche purchases, are allowed without special arrangement. Purchases are paid back by 'repurchases', in SDRs or currencies usable by the Fund.

The Fund's Policy Advisory Role

The Fund is required to oversee both the international

monetary system to ensure its effective operation, and the observance by each member of its obligations under the Articles of Agreement. To do the latter, the Fund must 'exercise firm surveillance over the exchange rate policies of members', who are required to provide it with the necessary information and to consult with it on their exchange rate policies when the Fund requests them to do so. The objective of surveillance is to encourage members to follow economic policies conducive to sustained economic growth with low inflation in an open world economy, and to avoid payments and exchange policies harmful to other members.

Surveillance applies to all members, but extra attention is given to the large industrial economies. Fund surveillance can help to reduce the incidence of rescheduling of external debt of developing countries in two ways: first, by contributing to a more stable expanding global economic environment which raises the prospects for all countries to meet external obligations and enhance their creditworthiness; and, second, by inducing indebted countries to adopt more appropriate policies than they might otherwise pursue.

Article IV Consultations

Article IV of the Articles of Agreement charges the Fund with reviewing the policies of its members affecting exchange rates. This in practice has been interpreted to include a wide array of economic policies. Consultations are held pursuant to Article IV, with each of the 152 members, in most cases annually. The Fund staff generally collect information required for surveillance during regular consultations with each member and during special consultations with certain members in connection with the Fund's world economic outlook exercises. Moreover, the Fund may also decide that developments in a member's exchange market or its exchange rate policies indicate a need for discussions with that member.

In appraising the member's policies, the Fund staff evaluate developments in the member's balance of payments, in light of the latter's reserves and external debt positions. This evaluation takes into account the contribution that domestic as well as external policies are making to balance of payments adjustment, and the extent to which the member's policies are fostering the conditions required for stability, sustained economic growth, and high employment. The staff's report is submitted with the approval of the Managing Director to the Executive Board, which reviews it before determining whether the member's policies are consistent with the principles of surveillance and its obligations under Article IV. The Managing Director's 'summing up' of the Board discussion is then transmitted to the authorities of the country.

Multilateral Surveillance

The Fund has also been called upon to play a crucial role in multilateral surveillance. Following the Louvre and Venice agreements the Fund has been developing indicators as well as economic analyses to assist the major industrial countries in evaluating their economic policies. It has been found that the medium-term scenarios, involving key indicators, are helpful in highlighting the international interaction of economic policies and developments. The Fund continues to explore the development of criteria that would be helpful in judging the sustainability and desirability of the evolution of a limited set of key economic variables.

Financing in Support of Growth-oriented Adjustment

The second principal function of the Fund is to provide financing in support of the balance of payments adjustment programmes of member countries. As of August 1989, the Fund had 49 arrangements of this nature with 46 countries, which was up from 46 in 40 countries a year earlier. There were undrawn commitments of SDR 10,232 mn, compared with SDR 3,533 mn a year earlier. Because countries undertaking such programmes often also request rescheduling of their external debt within roughly similar time periods, it is important to identify the terms and conditions of Fund lending, and the linkages which are often established between debt rescheduling and a country's relationship with the Fund.

Fund resources are made available to a member in balance of payments difficulty, but the amounts are: 1) limited in proportion to the member's quota in the Fund; 2) made available for short- to medium-term periods, usually three to five years, but as much as ten years under certain facilities; and 3) subject to conditions designed to assure attainment of viability in the member's balance of payments position over an appropriate period. A viable payments position has meant — especially for developing countries — a current account deficit that can be financed by capital inflow in terms that can be serviced through the growth of the economy, and without resort to additional restrictions on trade and payments (which would add to, rather than correct, existing distortions).

Policies carried out in the context of a Fund supported programme are essentially designed to restore domestic and external balance in the economy, thus setting the right conditions for sustainable growth over the medium term. Balanced economic policies include market-related levels for strategic prices, such as interest and exchange rates, which are fundamental 'supply-side' policies because they are crucial to the mobilisation and efficient allocation of savings. Fund-

supported programmes also emphasise measures directed explicitly at improving supply conditions and strengthening the productive base of the economy.

The extent and pace of overall adjustment is often dictated by external resource constraint. However, this does not imply that more financing and slower adjustment would be less costly. Members have a wide range of choice over specific adjustment measures; there is no single 'blueprint' which is applied by the Fund. Often, the 'seal of approval' given by the Fund to a member country plays the most important role in overall adjustments, since it can have a catalytic effect on other sources of finance.

The Fund provides direct financial support to members who are undergoing economic adjustment programmes in a variety of ways. The usual financing vehicles are the stand-by arrangements, and extended arrangements. For low income countries, there is additional assistance under the Structural Adjustment Facility (SAF) and the Enhanced Structural Adjustment Facility (ESAF), both of which cover three year adjustment programmes. At the end of the 1989 financial year, there were a total of 14 stand-by arrangements, two extended arrangements, 23 SAFs and seven ESAFs in effect [IMF Annual Report, 1989].

Credit Tranches, Stand-by and Extended Arrangements

The credit tranche policy is the Fund's regular or basic lending policy. A member can make purchases in four credit tranches, each equivalent to 25 per cent of its quota. A first credit tranche is one that raises the Fund's holdings of the purchasing member's currency in the credit tranches to no more than 25 per cent of quota. A member may use the Fund's resources in the first credit tranche — which may be appropriate if the payments deficit is relatively small — if the member demonstrates that it is making reasonable efforts to overcome its difficulties.

Subsequent purchases are made in successive tranches, the upper credit tranches. These drawings are subject to conditionality. The purpose is to assist the country while assuring that fund resources are used in support of policies to restore sustainable payments with economic growth. Such use is almost always made under stand-by or extended arrangements. A stand-by or extended arrangement enables the member to make purchases from the Fund, up to a specified amount, during a given period without further review of its policies, as long as it has observed the performance criteria and other terms included in the arrangement.

The duration of a stand-by arrangement is usually 12 months but may extend to a maximum of three years, with repayment within a period of three and one-fourth to five years after purchase. Extended

arrangements normally run for three years but may be lengthened to four years. The Fund's Extended Fund Facility (EFF) and the Fund's temporary policy on enlarged access allow members to borrow substantially higher percentages of quota than under the credit tranche policies. The repurchase of drawings under the EFF are made within four and one-half to ten years after each purchase. Repurchases under the enlarged access policy are made over a period of three and one-half to seven years.

Performance Criteria

Purchases of the amounts available under a stand-by or extended arrangement are available in instalments during the period of the arrangement. However, the member's right to draw is always subject to its observance of performance criteria, including possibly a further review of the situation described in the programme. The performance criteria typically cover credit policy, government or public sector borrowing requirements, and policy on trade and payments restrictions. They also frequently cover the contracting or net use of short-, medium-, and long-term foreign debt, and changes in external reserves. Performance criteria allow both the member and the Fund to assess the member's progress in carrying out policies during the stand-by or extended arrangement period. Failure to observe a performance criterion suspends purchases under the arrangement until the Fund and the member reach understandings, based on consultations and Executive Board action, for the resumption of purchases.

The Fund's Executive Board examines all requests for the use of the Fund's general resources (other than the reserve tranche purchases) to determine whether the proposed use will be consistent with the provisions of the Fund's Articles and policies.

The Structural Adjustment and the Enhanced Structural Adjustment Facility

The SAF was established in March 1986, in order to provide concessional financial assistance to low-income members who faced serious balance of payments difficulties and who need to undertake programmes of structural adjustment. Financing for the facility is being provided by the SDR 2.7 bn of Trust Fund reflows scheduled to become available during 1985-91. Loans carry an annual interest rate of 0.5 per cent, and repayments are made semi-annually between five and one-half and ten years after the disbursement.

The ESAF was established in December 1987 to provide additional finance to low income countries in balance of payments difficulties and undertaking structural adjustment programmes. It derives its finance mostly from loans and grants. The maturity of the loans, and the interest rate is the same as that under

SAF, but access under the ESAF is considerably larger. Whilst eligible countries may currently obtain a maximum of 70 per cent of their quotas in three tranches from the SAF, under the ESAF, access is expected to average about 150 per cent of quota over three years, but may reach up to 350 per cent in exceptional circumstances. The amount borrowed under ESAF depends on the strength of the country's adjustment effort, and size of its 'balance of payments problem'.

An eligible member seeking SAF or ESAF funds develops, with the aid of the Fund and the World Bank, a medium term policy framework for a three year adjustment programme set out in a 'policy framework paper' (PFP). This describes the macro-economic and structural policy priorities and objectives, as well as the structural reform and economic policy measures for the three-year period. It also contains a more detailed description of the structural reforms and economic policies to be implemented in the first year. This is updated annually on a three year rolling basis. An additional role envisaged for the PFP is that it serves as a basis to attract financial support from other sources, such as bilateral donors, by providing a coherent macro-economic and structural framework for such support.

Performance during a programme year is monitored by means of benchmarks, some of which are quantified, that reflect the programme's key objectives, targets, and policy goals. Although disbursements are not directly related to the observance of benchmarks, financial benchmarks are usually specified on a quarterly basis, and if deviations occur, policy adjustments are introduced as necessary, under the subsequent annual programme.

Other Facilities

Compensatory and Contingency Financing Facility

The Fund also has a number of facilities designed to meet the special needs of member countries. The Compensatory Financing Facility, CFF, established in 1963, was the first special facility created by the Fund. Its purpose is to provide financial assistance to members — particularly primary commodity exporting countries — experiencing balance of payments deficits resulting from export shortfalls. Such shortfalls must be temporary and largely attributable to circumstances beyond the member's control.

Initially, the CFF covered only shortfalls in earnings from merchandise exports, but coverage has since been widened. In May 1981, coverage was extended to provide assistance to members whose balance of payments were adversely affected by sharp increases in the cost of cereal imports. Members may base their requests for use of the CFF on export shortfalls alone or on a combination of export shortfalls and excesses

in the cost of cereal imports.

Purchases (loans) made under the CFF are additional to those that members may make under tranche policies. Repurchases (repayments) under the CFF are made in eight quarterly instalments, beginning three and a quarter years and ending five years after purchases.

In 1988, a further expansion of this facility was established, and it was renamed the compensatory and contingency financing facility (CCFF). This retains the essential features of the CFF, but adds a mechanism for contingency financing of member countries that have entered into adjustment programmes. The contingency mechanism partially protects programme countries from unanticipated disruptive movements in key account variables such as export earnings, import prices and interest rates.

The amounts of financing available to a member under the CCFF are up to 40 per cent of quota each on account of the export shortfall and the external contingency elements, and up to 17 per cent of quota for the excess cereal import cost. In addition, members may request to draw an optional tranche of up to 25 per cent of quota to supplement any one of these three elements. Where a member has a satisfactory balance of payments position — except for the effect of an export shortfall or an excess in cereal import costs — a limit of 83 per cent of quota applies for either of these elements. For countries in these circumstances, a combined limit of 105 per cent of quota on the use of the export shortfall and excess in cereal cost elements applies.

In addition to the cumulative limits on contingency financing of 40 per cent of quota (or 65 per cent of quota, including the optional tranche), such financing generally may not exceed 70 per cent of access under the associated arrangement. There is also a cumulative sublimit of 35 per cent of quota for contingency financing on account of deviations in international interest rates. Members are encouraged to obtain parallel financing from commercial banks and to use market mechanisms to reduce their exposure to interest rate risks.

Buffer Stock Financing Facility

The buffer stock financing facility was another facility designed to smooth out fluctuations in primary commodity prices, and thus variations in export earnings. It was established in 1969 to help finance members' contributions to approved international commodity buffer stock schemes. Drawings may be made for buffer stock financing up to the equivalent of 45 per cent of quota. As required for purchases under the CFF, the member is expected to cooperate with the Fund in an effort to solve its balance of payments difficulties. To date, the Fund has authorised the use of its resources in connection with tin, cocoa, rubber,

and sugar buffer stocks, but drawings have been made with respect only to tin, rubber, and sugar. Repurchase provisions are the same as for credit tranche and compensatory financing purchases, except that repurchases must be made if buffer stock contributions are returned to members. No loans on this facility are now outstanding.

Besides these facilities, the Fund also provides emergency assistance to member countries to meet payments problems arising from sudden natural disasters. Thus in 1988/89, SDR 71.8 mn was drawn by Bangladesh to cope with flood damage, and SDR 36.4 mn by Jamaica to meet foreign exchange needs following hurricane damage in September 1988.

Strengthening of International Debt Strategy, and the Fund's Role from May 1989

In May 1989, the Executive Board of the Fund approved new guidelines for the Fund's involvement in helping those developing countries who are members in facing serious debt problems. The guidelines provide for Fund support for commercial bank debt and debt service reduction by member countries.

All members are eligible for financial support of debt and debt-service reduction schemes, under the new guidelines issued by the Fund, provided that certain conditions are met. The Fund must be satisfied that:

- 1) the member is pursuing an economic adjustment programme with strong elements of structural reform, in the context of a stand-by or extended arrangement
- 2) voluntary, market-based, debt and debt-service reduction will help the country regain access to credit markets and achieve external payments viability with economic growth
- 3) financial support for debt and debt-service reduction represent an efficient use of scarce resources.

In reaching a judgement on each of these points in a particular case, the Executive Board will be guided by a number of considerations. These include whether the member is pursuing policies designed to improve the climate for saving and investment, help reverse capital flight, and attract private capital inflows and direct investment.

The guidelines provide that the proportion of Fund resources committed under an extended or stand-by arrangement that could be set aside to reduce the stock of debt would normally be about 25 per cent, although the exact proportion would be determined on a case-by-case basis (for example, it is 30 per cent in the Mexican case), drawings on set aside amounts would normally be phased, in line with the member's performance under the adjustment programme. However, some front-loading or phasing in accordance with specific financing needs of the member's debt

reduction plan may be permitted.

In certain cases, the Fund would consider additional access to its resources, provided that such support would be decisive in promoting further cost-effective debt and debt-service reduction, and in catalysing other financial resources. Such additional access, of up to 40 per cent of the member's quota, can be used for interest support in connection with debt and debt-service reduction. Actual access will be determined case-by-case, in the light of the magnitude of the member's balance of payments problems, the strength of its adjustment programme, and its efforts to contribute its own resources to support debt and debt-service reduction.

The Fund will periodically review the progress of individual operations to ensure that a substantial reduction in debt or debt-service reduction obligations is occurring, consistent with movement towards a sustainable balance of payments position for the debtor. The Fund will not, however, be directly involved in the negotiations between members and their bank creditors. The Executive Board has stressed the importance of close collaboration between the Fund and the World Bank in supporting effective debt reduction operations by member countries.

Fund practices with respect to assurances on bank financing have varied, depending on a variety of considerations. The objectives of the policy on financing assurances are to ensure that: adjustment programmes are adequately financed; that financing helps return the country to a viable balance of payments position, enabling it to repay the Fund; the burden of financing is shared equitably; and orderly relations between the member country and its creditors are maintained or re-established.

The new guidelines modify the policy on financing assurances, in the light of the changes in the financial environment, and the possibility that debtors may need time to agree on financing packages with their creditors. These guidelines have a provision for the Fund to approve an arrangement before the conclusion of a financing package between the member and its commercial bank creditors. Approval may be given where prompt fund support is essential for programme implementation, where negotiations with banks have begun, and where an appropriate financing package is expected to be concluded within a reasonable period of time. When circumstances warrant, the practice of seeking a 'critical mass', and the possibility of approving an arrangement in principle, will continue to be followed. In such situations, a critical mass of bank commitments is obtained prior to approval of a stand-by or extended arrangement by the Executive Board, or the arrangement is approved in principle, but does not come into effect until a critical mass has been secured by the banks.

In promoting orderly financial relations, every effort will be made to avoid arrears, which could not be condoned or anticipated by the Fund in the design of programmes. Nevertheless, an accumulation of arrears to banks may have to be tolerated where negotiations continue and the country's financing situation does not allow them to be avoided. The Fund's policy of non-tolerance of arrears to official creditors remains unchanged.

Following the adoption of the operational guidelines for its support of debt and debt-service reduction in May 1989, the Fund approved arrangements involving such support for four countries — Costa Rica (on May 23), the Philippines (on May 24), Mexico (on May 26), and Venezuela (on June 23).

For the Philippines and Venezuela, the Board approved extended arrangements, and set aside 25 per cent of resources approved under the arrangements

for debt reduction. A stand-by arrangement was approved for Costa Rica, with 25 per cent set aside for debt reduction. All four arrangements also provide for the possibility of additional resources of up to 40 per cent of the member's quotas for debt-service reduction.

Conclusion

Thus one should stress that the way forward does not lie in unilateral approaches, whether one is a creditor or a debtor. Rather, all actors in the situation, both debtor and creditor countries, commercial banks and the international institutions themselves, must recognise their common interest in reaching a realistic understanding of the situation. From this, one can move towards a situation where an end to the process of debt workout is in sight, and in which the possible solutions can be freely negotiated and market based.

IMF Facilities: Amounts Committed and Terms of Credit, April 30, 1989

| <i>Credit Facility</i> | <i>SDR million amount committed but undrawn as of April 30</i> | <i>No. of arrangements in effect</i> | <i>Available to:</i> | <i>Interest rate</i> | <i>Duration of arrangement</i> | <i>Repayment period</i> | <i>Conditionality</i> |
|------------------------|----------------------------------------------------------------|--------------------------------------|-----------------------------------|-----------------------|--------------------------------|--------------------------|-----------------------|
| Stand-by | 3054 | 14 | All members | Variable ² | 1-3 years | 3½-5 years ¹ | Yes |
| EFF | 1032 | 2 | All members | Variable ² | 3-4 years | 4½-10 years ¹ | Yes |
| CCFF | NA ¹ | 5 | All members | Variable ² | 1 year | 3-5 years | Depends upon BoP |
| BSFF | NA ¹ | None | All members | Variable ² | 1 year | 3-5 years | Depends upon BoP |
| SAF | 1566 | 23 | Low income undertaking adjustment | 0.5% | 3 years | 5½-10 years | Yes |
| ESAF | 955 | 7 | Low income undertaking adjustment | 0.5% | 3 years | 5½-10 years | Yes |

Source: IMF Annual Report, 1989; Table 11.2, p.60, 11.3, p.61, and information provided by the author.

¹ CCFF and BSFF resources are normally drawn in full by members as soon as the Fund approves access; thus, undrawn balances seldom exist. Five countries drew SDR 238 mn under the CCFF during the Fund's financial year ending April 30, 1989; there were no BSFF drawings.

² The Fund charges interest based on the cost of its funds plus a margin for operating expenses and additions to reserves. The charges vary from period to period. For example, the basic rate of charge applied to the use of the Fund's ordinary (quota) resources was 5.50 per cent in the first half of the Fund's 1988/89 financial year, but increased to 7.38 per cent in the second half of the year.

³ Resources provided under the enlarged access policy to augment drawings under standby and EFF arrangements are repaid over a period of three and one-half years to seven years after they are purchased. The Fund borrows these resources at market-related rates, and drawings under the enlarged access policy carry an interest charge reflecting the Fund's cost of borrowing plus a small margin. The average rate of charge in FY 1988/89 was 7.62 per cent.