15

Extended and Specialized Lending

The IMF's primary purpose in lending to its member countries is to provide short-term balance of payments assistance. The preceding two chapters have described how the Fund's policies evolved to help ensure that borrowers would adjust their policies to restore viability to their economies and external accounts, and how special lending operations were developed to handle the problems of low-income countries. Now the focus shifts to the other special windows that provided assistance in particular circumstances during the 1980s.

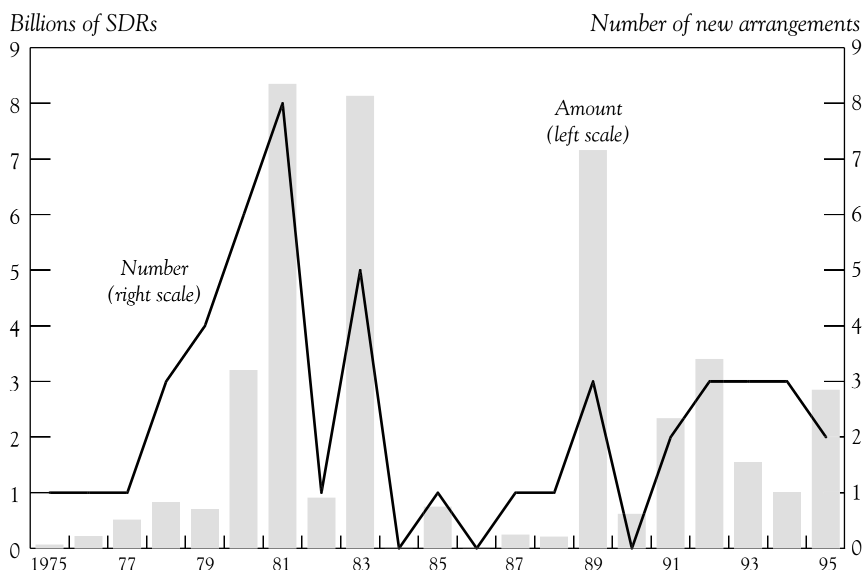
First, the Extended Fund Facility (EFF)—the most general of these windows, established in 1974—offered countries the option of longer-term credits. Second, the Compensatory Financing Facility (CFF)—the oldest special window, established in 1963—offered credits to compensate for the effects of temporary fluctuations in the value of exports or imports. The 1988 successor to the CFF, the Compensatory and Contingency Financing Facility (CCFF), also provided incremental financing in case of certain unforeseeable events. Third, the Buffer Stock Financing Facility (BSFF) began in 1969 to offer credits to assist countries participating in specified international arrangements for marketing primary commodities. Fourth, although no separate facility was ever created for the purpose, the Fund has on numerous occasions since the early 1960s provided emergency financing to countries hit by natural disasters. Each of these operations is reviewed in the following sections of this chapter. (For a complete summary of the Fund's lending operations in the 1980s, see Chapter 1, Table 1.1.)

Extended Fund Facility

The EFF was established in 1974 as a vehicle for longer-term lending to countries in need of structural economic reforms. It offered larger credits and longer repayment periods than ordinary stand-by arrangements, but in return it required more stringent commitments to adjust and reform economic policies. The Fund struggled to get the balance right: how much to require and how much to offer in return. As it did so, demand for EFF credits went through some wide cycles.

During the first four years of operation up to the start of the present History (see de Vries, 1985, Chapter 19), the Fund completed just six arrangements through the EFF, accounting for less than 10 percent of total Fund lending in 1975–78 (Fig-

Figure 15.1. Extended Arrangements Approved, 1975–95



ure 15.1).[1] The next five years (1979–83) were the real heyday of the facility: 24 new arrangements were approved, and more than 40 percent of Fund conditional lending was made through the facility. A fallow period then ensued, with just three new arrangements in more than five years, before the facility was given new life in 1989 as an adjunct to the Brady Plan (Chapter 11).

When the EFF was first established, a typical ordinary stand-by arrangement—which was still intended to be the normal vehicle for the Fund's conditional lending—lasted one year. That is, the country borrowed in quarterly installments spaced over 12 months and committed itself to carrying out specified policy adjustments through that year. The money was to be repaid in quarterly installments beginning after the end of the third year and concluding two years later. EFF programs, in contrast, typically lasted three years, and credits initially were to be fully repaid within eight years (i.e., five years after the end of the program, which normally coincided approximately with the final disbursement). The maximum size of an extended arrangement was larger than for a stand-by arrangement (initially 140 percent of quota rather than 75 per-

[1]The amounts graphed in Figure 15.1 represent the initial value of arrangements approved in the indicated year, plus any augmentation of previously approved arrangements. (In 1990, for example, the chart shows that no new arrangements were approved, but a positive amount is shown, which reflects augmentation of two arrangements approved in 1989.) These are gross totals that do not reflect early cancellations or reductions in size. The indicated number of new arrangements does not include three cases in which an existing arrangement was canceled and replaced by a new one covering the remaining period of its predecessor.

cent).[2] The only formal difference in conditionality was that to apply for an extended arrangement, the country had to submit a policy plan for the full three years, but the Fund also expected EFF borrowers to be making structural as well as stabilizing improvements. Charges on credits were the same under both facilities.

The EFF was given a boost in 1979 when the Supplementary Financing or "Witteveen" Facility (SFF) finally came into effect after a long delay (Chapter 17). Although the provisions on the use of the SFF were rather Byzantine, in essence it enabled countries to roughly double the amounts they could borrow by supplementing the Fund's own resources with money borrowed from a group of official creditors. Under a standard three-year EFF arrangement, a country now could borrow up to 280 percent of quota: 140 in "ordinary resources" and 140 in borrowed resources. If the first credit tranche was still available as well, total access could reach 305 percent of quota. (The SFF was available for regular stand-by arrangements as well; in that case, the maximum level of access rose from 100 percent of quota to just over 200 percent.) Just as important, the SFF decision included a "special circumstances" clause under which the Fund could lend even larger amounts, in which case the excess would be funded entirely out of borrowed resources. First informally, and later through an explicit policy, the effective ceiling on access became 450 percent of quota for countries with three-year programs and with no outstanding obligations from earlier stand-by arrangements.

The extra money was a little more expensive, since the interest rate on borrowed resources was equal to the Fund's own borrowing rate plus a markup, and those funds had to be repaid in seven years rather than eight.[3] Nonetheless, potential borrowers now had a greater incentive to formulate the lengthier and more detailed programs that were needed to qualify for extended rather than ordinary stand-by arrangements. Although the resources of the SFF were fully lent out by March 1981, the Fund arranged to borrow a substantial amount of additional money (see Chapter 17) that it used to finance a new "enlarged access" policy, which worked in much the same way as the SFF.

When the Executive Board conducted its second review of the EFF in June 1979, it declined to make any changes in the way the facility operated. Almost immediately afterward, however, the world economy—and many developing countries in particular—suffered a shock when world oil prices were raised sharply by the major exporters. When the Fund's governors convened in Belgrade at the end of September, the Development Committee asked the Executive Board to extend the maximum repayment period from 8 years to 10 and to try to find some means of reducing the cost of supplementary financing. The Interim Committee endorsed the request the next day, and the Board approved the extension to 10 years before

[2]In both cases, for a country with no outstanding obligations, an additional 25 percent of quota could be borrowed by drawing on the "first credit tranche." For an introduction to the Fund's "tranche policies," see the Preface. The complex and shifting limits on overall access in relation to quotas resulted from political compromises in the Executive Board. For a detailed review, see Chapter 17.

[3]Beginning in December 1980, low-income countries were eligible to receive a subsidy to reduce or eliminate the excess over the Fund's regular interest rate.

the end of the year. It was not a momentous change, but it did stretch out the average maturity of EFF arrangements by a little over one year.[4]

While the Fund was making the EFF more attractive to borrowers, it also was introducing changes in the rules on ordinary stand-by arrangements that resulted in a blurring of the distinctions between the two. To be eligible for supplementary or enlarged financing, a stand-by arrangement had to be longer than one year and could be as long as three years "in exceptional cases." With that change, a country could obtain a commitment for three years of financing, up to a maximum of at least 165 percent of quota (and possibly as much as under an EFF arrangement), without having to specify a detailed multiyear program of structural adjustment.[5] Although a larger ceiling nominally applied to the EFF, in either case the ceiling could be waived if the Board was prepared to invoke the "special circumstances" clause. In practice, however, the Board approved only three three-year stand-by arrangements: for Turkey, in June 1980 (SDR 1.25 billion, which was 625 percent of the quota that was then in effect and 417 percent of the quota that had been approved to take effect in December; equivalent to $1.7 billion), for Yugoslavia in January 1981 (SDR 1.66 billion, or 400 percent of quota; $2.1 billion), and for Romania in June 1981 (SDR 1.1 billion, or 300 percent of quota; $1.3 billion). Most stand-by arrangements in 1980–81 (the peak period for longer-term stand-by arrangements) provided well under 200 percent of quota. In contrast, for countries borrowing through the EFF, by 1980 nearly all arrangements were for more than 280 percent of quota and several totaled more than 400 percent.[6]

Besides being larger, EFF arrangements were intended to support structural reforms. By the second half of the 1980s, structural reforms also were included in many of the programs supported by ordinary stand-by arrangements, but in the

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[4]The two committee reports may be found in *Annual Report 1980*, Appendix III. The amendment to the EFF decision is on p. 145 of the same publication. For the original decision on repayments, see de Vries (1985), Vol. 3, p. 505. In addition to making the maximum repayment period 10 years, the amendment provided for repayments to be made at six-month rather than quarterly intervals. For further details, see "Extended Fund Facility—Extension of the Maximum Repurchases Period," SM/79/270 (November 14, 1979) and the minutes of EBM/79/179 (December 3, 1979).

[5]The provisions of the SFF and the enlarged access policy specified a higher ratio of borrowed to ordinary resources for stand-by arrangements than for extended arrangements. Because the seven-year maturity on borrowed resources was higher than the standard maturity on stand-by arrangements but lower than the standard maturity on extended arrangements, these policies lengthened stand-by arrangements and shortened extended arrangements. Under the access rules that were in effect through most of the 1980s, an EFF credit had an average maturity of just under 6 years, compared with just under 5 years for a stand-by arrangement. Without the use of borrowed resources, those figures would have been 7¼ and 4⅛ years, respectively. "Reconsideration of the Extended Fund Facility," EBS/88/7 (January 20, 1988), p. 5.

[6]In 1981, the Fund approved 17 stand-by arrangements, for a total commitment of SDR 4.75 billion ($5.6 billion). Commitments in relation to quota ranged from 25 to 400 percent, with a median of 125 percent. In the same year, the Fund approved 10 EFF arrangements totaling SDR 9.53 billion ($11.2 billion). Those commitments ranged from 213 to 450 percent of quota, with a median of 358 percent.

early 1980s, this special requirement of the EFF was still a distinguishing feature. Sri Lanka, which borrowed SDR 260 million ($325 million; 291 percent of the initial quota) in 1979–81, was a classic example.

For several years prior to 1979, the Sri Lankan economy suffered from serious economic mismanagement characterized by nationalization, an inward-looking development strategy, a highly distorted price system, and extensive subsidization of consumer goods. A new government, headed by J.R. Jayewardene, took power in 1977 and set out to introduce market-oriented reforms. The Fund responded quickly with a one-year stand-by arrangement approved in December 1977, but it was obvious that reforms would have to be introduced and sustained over several years. Consequently, while the stand-by arrangement was in place in 1978, the staff negotiated a three-year extended arrangement aimed specifically at supporting the liberalization of prices and the associated reduction of subsidies. Those reforms were carried out successfully, and—with some delays—the arrangement was fully drawn through 1981.[7]

The role of the EFF in supporting reform was not always so straightforward. One of the more controversial cases was also the largest: the arrangement for Sri Lanka's northern neighbor, India. An examination of this case illustrates the difficulty of setting standards for EFF arrangements that differ enough from conventional stand-by arrangements to warrant running it as a separate facility.

India

The government of India approached the Fund for assistance in November 1980, after a severe drought, the sharp rise in international oil prices, and a generally weak global economy had brought both a sharp setback to the balance of payments and a surge in inflation. When the drought ended, output did not rebound, and the rains thus uncovered the structural weaknesses in the economy, notably bottlenecks in essential industries and in infrastructure. These problems had been masked through much of the 1970s by favorable weather and external conditions. The authorities recognized that the solution lay in a major overhaul of the public investment program, aimed at greatly increasing its efficiency. (See Joshi and Little, 1994, pp. 58–62 and 143–169.) As the government developed its Sixth Five-Year Plan (to cover 1981–85), it decided to supplement its already large use of World Bank resources (then roughly $2 billion a year, of which some 80 percent was in very long-term concessional loans from the International Development Association) with a major macroeconomic adjustment program to be supported by an extended arrangement from the IMF.[8]

[7]See "Sri Lanka—Use of Fund Resources—Extended Fund Facility," EBS/79/16 (January 11, 1979) and "Sri Lanka—Mid-Term Review of the Extended Arrangement, 1981," EBS/81/210 (October 20, 1981).

[8]For further background, see memorandum from Tun Thin (Director of the Asian Department) to the Managing Director, and attached draft briefing paper (December 31, 1980); IMF/CF (C/India/810 "Mission, Tun Thin and Staff, January 1981").

The decision to request the use of Fund resources was controversial and highly political in India. The prime minister, Indira Gandhi, was personally active in (and would later become the chairperson of) the Non-Aligned Movement, which was officially opposed to IMF conditionality. Drawing on the Fund would subject her government to criticism from leftist parties in parliament (see Mansingh, 1984, esp. pp. 335–37). The key for overcoming the opposition would be to ensure that the government was not required to alter the economic policies already envisaged under the Five-Year Plan. Officials in the finance ministry and the reserve bank were convinced that the existing Plan was strong enough to meet the Fund's conditions for an extended arrangement, and on that basis, the prime minister gave the go-ahead to enter into secret negotiations. Accordingly, on November 25, 1980, R.N. Malhotra (Secretary for Economic Affairs in the Ministry of Finance) visited the Managing Director at the Fund to signal his country's interest in obtaining a credit arrangement under the EFF.[9]

The requested EFF arrangement was controversial at the Fund as well. India faced enormous structural as well as macroeconomic problems, associated with longstanding traditions of developing indigenous production for domestic consumption, of relying on state enterprises for industrial development, and of shunning the liberalization of policies and markets that was essential for the promotion of international trade.[10] Despite the role of the EFF, a program that was *primarily* structural was still seen in Washington as fundamentally the province of the World Bank, not the IMF. On the macroeconomic side, it was not clear that India had a balance of payments problem that justified drawing on a substantial volume of Fund resources. Because the quota increases envisaged under the Eighth General Review had been delayed (see Chapter 17), those resources were already scarce and would be further squeezed by a program with one of the world's largest developing countries. If India faced a balance of payments need, the Fund was prepared to help finance it, but the case would have to be strong.

Another controversy concerned whether the program, as measured by the performance criteria being imposed, was sufficiently strong to warrant such a large commitment of Fund resources. To a large extent, the Indian government preempted the Fund's conditionality by anticipating the standard requirements for an extended arrangement and incorporating a substantial macroeconomic adjustment

[9]IMF/RD, Asian Department file "India—Correspondence, F.O., 1979–1980" (Accession 82/37, Box 2, Section 139); file memorandum by P.R. Narvekar (Deputy Director of the Asian Department).

[10]It is impossible to understand Indian economic policy in the 1970s and 1980s without relating it to the experience of the preceding three centuries. When Mohandas K. Gandhi led India to independence in 1947, a major economic goal was to reverse the trade deficit that had developed under colonial rule by redeveloping traditional labor-intensive trades and industry. Even Adam Smith described the dominant economic role of Britain's East India Company as in direct conflict with India's interests; Erik Erikson described it as "hit-and-run exploitation"; and Jawaharlal Nehru described British economic power in a letter to his daughter, Indira Gandhi, as "the foundation and the basis of the Indian problem of poverty." To Gandhi and his successors, import substitution was an essential means of restoring India's identity as a nation. See Erikson (1969), pp. 268–74.

both in the government budget and in the five-year plan. The staff in the area department were content to develop a program that did little more than require India to carry out its own intentions, but the reviewing staff in some other departments—notably the Exchange and Trade Relations Department (ETR) but also Fiscal Affairs—strenuously objected. ETR staff members in particular insisted on stronger adjustment before they would support the program.[11] Some observers later concluded that the Indian program epitomized the weakness of the Fund's conditionality in that period,[12] while others saw it as a shining example of a government's willingness and ability to design and carry out its own adjustment program. Jacques J. Polak (Executive Director for the Netherlands), for example, concluded later that the "Fund could wish no more than to exercise its leverage with all prospective borrowers in the way it did in the Indian case" (Polak, 1991, p. 13n).

The first negotiating mission went to New Delhi in January 1981, led by Tun Thin, Director of the Asian Department. Because India's proposed program was linked to a detailed capital investment program under the Sixth Plan, the staff consulted extensively with their counterparts in the World Bank before going to India.[13] Subsequently, World Bank staff were asked (exceptionally, for that period) to join the Fund missions and to provide advice on those issues. Because the Fund did not believe that it had either a mandate or the expertise to evaluate some of the main structural measures, the staff deferred to the Bank in that field.

Under the access limits then in effect, India could draw up to SDR 7.7 billion ($9 billion) from the Fund over a three-year period (equivalent to 450 percent of its quota). Of that amount, up to SDR 2.4 billion (140 percent of quota) could be drawn from the Fund's own resources; the remainder would come from borrowed funds. The initial informal request by the authorities was to draw only the portion available from the Fund's own resources, but the staff was concerned that the medium-term outlook for the balance of payments was bleak enough to warrant a larger program.[14] That plan was feasible because India's long run of good years in the 1970s had left it with a quite modest debt burden (less than 15 percent of

[11]IMF/CF (C/India/840 "Fund/Bank Mission, Tun Thin and Staff, April 1981"); memorandums from Donald K. Palmer (Deputy Director, ETR) and Richard Goode (Director, Fiscal Affairs Department) to management (both dated May 14, 1981). This relationship between ETR and the area departments was a regular feature of the internal process of evaluating adjustment programs, but the strains were more severe in this case than in most. For an account of the controversy from the ETR perspective, see Finch (1997), pp. 215–16.

[12]In the congressional testimony mentioned below (p. 714), the U.S. Executive Director expressed the concern of his authorities that the program lacked specificity on structural reforms. Joshi and Little (1994, p. 60) described the credit ceilings in the program as "rather generous" and "well within reach." The Executive Director for India, M. Narasimham, took an intermediate view and later wrote that "one cannot say that the Fund was unduly considerate or that India got off lightly" (Narasimham, 1988, p. 72). Many contemporary observers in India, however, viewed the program as a heavy-handed interference with the country's policies. See Gwin (1983) for a balanced assessment of various criticisms of the arrangement.

[13]Memorandum from Tun Thin to the Managing Director (January 15, 1981); IMF/CF (C/India/810 "Mission, Tun Thin and Staff, January 1981").

[14]See p. 9 of the briefing paper for the January 1981 mission (December 31, 1980); IMF/CF (C/India/810 "Mission, Tun Thin and Staff, January 1981").

GDP). Although the requested financial support was not unusually large relative to India's quota, at SDR 5 billion ($6 billion) it was at the time the largest commitment for the use of Fund resources in history.[15]

The starting point for negotiations was that macroeconomic performance was poor and was aggravated by the very closed economic system. Although economic growth was beginning to recover by the time discussions started with the Fund, everyone agreed that production and distribution bottlenecks and bureaucratic rigidities were preventing the Indian economy from living up to its potential. From the beginning, the authorities sought to implement both stabilization and liberalization measures, though the Fund staff pressed for more boldness on both fronts. Because domestic political opposition was strong, the authorities were particularly eager to ensure that the program would be seen as homegrown. On its side, the staff was concerned that reforms be lasting, so that the balance of payments would be sustainable beyond the end of the three-year program period.

Following the first two missions (January and April), several key issues related to the specification of monetary, fiscal, and liberalization measures remained to be resolved before the program could be sent to the Executive Board for approval. Four more negotiating sessions then were held during the spring and summer of 1981. Because of concerns about news leaks on these sensitive negotiations, the meetings were held at various locations outside India: in Libreville (Gabon), Paris, London, and Washington. The atmosphere at these sessions was unusually collegial, reflecting the authorities' commitment to a strong adjustment aimed at avoiding pressures on the balance of payments. Finally, the finance minister, R. Venkataraman, met with the Managing Director, Jacques de Larosière, in Washington just before the 1981 Annual Meetings, and resolved the final outstanding issue, namely the phasing of purchases. Venkataraman then signed and submitted the Letter of Intent on September 28.[16]

Approval of the program by the Board was not to be easy. The amount was large at a time when the Fund's liquidity position was still coming under pressure because of the slow pace of the general quota review. Although India faced a large external deficit, it was a creditworthy country that some Executive Directors felt could have tapped commercial creditors to a greater extent. Also, the program negotiations had brought the Fund more heavily into structural issues than in earlier cases, and some Directors worried that the Fund was financing development rather than helping to correct a balance of payments problem. The Board meeting was scheduled for November 9, 1981, and both de Larosière and the Deputy

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[15]The arrangement for India held the size record until the Fund approved a 12-month stand-by arrangement for Mexico in February 1995, under which Mexico could draw up to SDR 12.1 billion ($17.9 billion). Over the next four years, the Fund then approved four more arrangements totaling the equivalent of $10 billion or more: for Russia, Indonesia, Korea, and Brazil. As of 1999, the record commitment was a December 1997 stand-by arrangement for Korea totaling SDR 15.5 billion ($21 billion).

[16]See "India—Use of Fund Resources—Extended Fund Facility." EBS/81/198 (October 7, 1981) and Sup. 1 (October 8). Additional information in this paragraph is from background interviews.

Managing Director, William B. Dale, set out to determine the likely degree of support among Directors, through informal meetings and bilateral contacts. Management felt that the nature of the program was appropriate, because the use of EFF resources to promote a specific investment program was seen as essential if the balance of payments was to be sustainable in the longer run. Furthermore, India was planning to obtain substantial additional resources from both commercial and official sources. The Fund was playing a catalytic role as well as providing direct financing.

Curiously, the content of the program—the conditionality—was not especially controversial at the Board meeting. Curious, not only because of the intense internecine battles that accompanied the negotiations but also because the structural elements of the program were at once more detailed than had been customary and yet much less than what was required if India was to break loose from the inward-looking policies of its past. The structural policies described in the arrangement were not specific performance criteria but rather were commitments by the government that were to be reviewed as part of the background for developing the criteria for the second and subsequent years of borrowing. Though that treatment was customary, it did open the door for criticism that the Fund would have little control over the most important elements of the program.

The risks in this process were high, because the Indian government had staked its own prestige on the program, and because the Fund's commitment of resources was so large. In the midst of the effort to line up support within the Board, the staff report was leaked to the Indian press. The reporter indicated that he had obtained a copy from an Executive Director,[17] but an internal investigation at the Fund did not clarify the source. Because of the sensitivity of the information and the delicacy of the negotiations, management regarded this leak as "quite possibly the most serious and damaging . . . in the history of the Fund."[18]

Meanwhile, even the phasing of scheduled drawings had become a political issue, because of concerns that the backloading would be seen as a concession and a sign of weakness on the part of the authorities. The full schedule was not included in the staff report, as it normally would have been, but it was agreed upon separately. Consequently, it became necessary to be sure that everyone understood and agreed.

When the Board met, Richard D. Erb (United States) abstained on the grounds that India did not need as much money as it had requested and could meet its financing needs through borrowing from commercial banks. Other Directors also expressed misgivings. A.R.G. Prowse (Australia), for example, concurred with the United States that there was no real balance of payments need to justify the EFF arrangement. Prowse and others worried that the request was a disguised effort by the authorities to get the Fund to provide medium-term financing for their capital investments. The staff noted, however, that the balance of payments deficit was related to structural imbalances in production and trade and thus qualified for sup-

[17]See articles by N. Ram in *The Hindu* (Madras), October 16 through October 21, 1981.

[18]See statement by Dale at EBM/81/133 (October 21, 1981), p. 3.

port under the 1974 EFF decision. That argument carried the day, and the program was approved, with only the United States abstaining.[19]

The U.S. abstention subsequently became a political issue in the United States, as some legislators insisted that the program should have been rejected because of India's commitment to spend $3 billion buying Mirage fighter jets from France. Perhaps piqued because the contract did not go to an American company, they called a hearing in the House of Representatives and asked Erb to testify (see Erb, 1981). Erb insisted in his testimony that military spending was a matter of national sovereignty and was outside the purview of the Fund. That was also the Fund's official position, although the staff was already beginning to view large and rising military spending by countries with serious balance of payments problems as an economic problem. A decade later, such issues would be treated much more openly, and the question of whether such a large increment to the military budget was appropriate when the country was requesting a major use of Fund resources might have been a key issue in the negotiations and the Board's deliberation. At the time, however, India successfully insisted that the purchase be kept out of the picture.

Following the Fund's approval, the Indian government continued to be attacked in parliament for subjecting itself to Fund conditionality. The authorities successfully argued, however, that the EFF arrangement did not impose conditionality at all, because it was fully consistent with the policies that were already incorporated in the Sixth Five-Year Plan. As the prime minister put it in a parliamentary speech that December, the arrangement

> does not force us to borrow, nor shall we borrow unless it is for the national interest. There is absolutely no question of our accepting any programme which is incompatible with our policy, declared and accepted by Parliament. It is inconceivable that anybody should think that we would accept assistance from any external agency which dictates terms which are not in consonance with such policies.[20]

When the Executive Board met a few months later, in April 1982, to conduct the first program review, the program was going well, but the same concerns surfaced that had been raised in November. Erb repeated his view that part of the arrangement should have been put on a contingent basis, to be available only if the balance of payments turned out to be bad enough to warrant it. Robert K. Joyce (Canada) was concerned that there was too little financing from commercial sources. Prowse was worried that there was too much overlap with the Bank. In response, the Managing Director noted the high level of commercial financing, the staff stressed that the Fund relied entirely on the Bank for structural advice, and M. Narasimham (India) argued that reluctance to borrow had not constrained the investment program.[21] In addition to those concerns, Jon Sigurdsson (Iceland) raised the question of whether India could really afford the jets, but he was a decade ahead of time in suggesting that the Fund should concern itself with the viability of mili-

[19]Minutes of EBM/81/138–139 (November 9, 1981).
[20]Quoted in Mukherjee (1984), pp. 61–62.
[21]Minutes of EBM/82/48–49 (April 15, 1982).

tary spending. No other Director backed him up when his concerns were criticized by Narasimham, who "was surprised and concerned . . . that the question of India's military expenditures had been raised in the Executive Board. Discussions of such an issue in the Board would open a veritable Pandora's box, and could have significant implications for the Fund's relations with member countries."[22]

The next two reviews (July 1982 and February 1983) went smoothly, as both the balance of payments and economic growth stayed roughly in line with expectations. Much of this success—on both fronts—was attributable to the unexpectedly rapid development of the Bombay High and other offshore oil fields. In addition, the boom in economic development in the nearby oil-exporting regions of the Middle East had spilled over into a boom in workers' remittances in India. More generally, the central bank (the Reserve Bank of India) had quietly shifted to a more flexible exchange rate policy, gradually devaluing the rupee against a basket of currencies without any public announcement or political debate.[23] Otherwise, liberalization was minimal: there were no new takeovers of ailing industries, but also no privatization, and much of the capital investment program was in the hands of state enterprises; some quantitative trade barriers were replaced by tariffs, but the tariffs were set high enough to effectively limit trade; fertilizer prices were raised substantially, but they remained well below economic levels.

India continued to meet all of the performance criteria for the EFF arrangement and to make each drawing on time. The tone of the Board meetings gradually shifted, as the earlier concerns were outweighed more and more by admiration for the success of the adjustment program. By April 1983, when a staff mission visited India to negotiate the third year of the program, economic growth had slowed sharply, but overall the program was still on track and the prospects for a recovery were good. The Executive Board met in July, and although Erb still expressed "major reservations" over the handling of the arrangement, he joined other Directors in supporting it.[24]

By the end of 1983, India had drawn SDR 3.3 billion of the original SDR 5 billion. Another 600 million would become available upon completion of the January 1984 review, and the final 1.1 billion would be subject to negotiation of the fourth year of the program. By that point, however, the authorities were seriously questioning whether they needed the rest of the money. Renouncing it would have several advantages: it would demonstrate both to the population at home and to

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[22]Minutes of EBM/82/48 (April 15, 1982), pp. 29–30 (Sigurdsson); and EBM/82/49 (same date), p. 15 (Narasimham). The Fund first took a formal position on the role of military spending in national economic policy in October 1991. At that time, Executive Directors concluded that, "as military expenditure can have an important bearing on a member's fiscal policy and external position, information about such expenditure may be necessary to permit a full and internally consistent assessment of the member's economic position and policies" (*Annual Report 1992*, p. 53).

[23]From 1927 until the 1970s, the rupee was pegged to the pound sterling, with one devaluation in 1966 and one effective revaluation when sterling (but not the rupee) was devalued against the dollar in 1967. That link was temporarily abandoned during the turmoil in currency markets in the second half of 1971 and was broken for good in September 1975 when India shifted to the practice of managing the rupee against a basket of currencies without announcing the composition of the basket.

[24]Minutes of EBM/83/108–109 (July 22, 1983).

the world at large that India was in control of its own finances and had undertaken a successful adjustment program; and it would release scarce IMF resources for use by other developing countries. On January 15, 1984, Prime Minister Gandhi announced in a nationwide radio broadcast that the country's balance of payments was now strong enough that the government could forgo the final year's drawings from the Fund. Two weeks later, the Executive Board met for the last time on this issue. The drawing of SDR 600 million was approved, and the Board welcomed India's decision to continue with the adjustment program while forgoing the rest of the money.[25] Finally, on April 6, 1984, Mukherjee wrote to de Larosière requesting cancellation of the arrangement, effective May 1.[26]

Collaboration with the World Bank

The EFF arrangement for India was only one example of how the Fund and the World Bank tried to coordinate their efforts in supporting structural reforms in countries that were borrowing for that purpose from both institutions. From the beginning of EFF lending in 1975, the evaluation of borrowers' longer-term policy plans required Fund staff members to consult frequently with their counterparts in the Bank. The difficulty was to decide just how far to go in deferring to the Bank on structural issues.

In June 1980, as part of a general review of collaboration between the Fund and the Bank (see Chapter 20), the Executive Board agreed that the Fund should continue to look to the Bank for views "on development priorities as reflected in the size and composition of the investment program, recurrent outlays, the efficiency of resource use, and individual pricing decisions."[27] Yet no specific rules or policy governed collaboration on the ground, and no formal distinction was made between the handling of stand-by and extended arrangements.

Through March 1981, in the absence of a general policy, actual practice varied from case to case. During 1980 and the first quarter of 1981, in the context of the Fund's consideration or review of EFF programs for 12 countries, the Bank provided detailed appraisals of investment programs in four cases (Côte d'Ivoire, Honduras, Senegal, and Sudan). In four others, the Bank agreed to provide assessments at a later stage (Guyana, Morocco, Pakistan, and Sierra Leone). In the remaining four cases, the Bank declined to provide an evaluation, either because it was not actively lending to the country or because the government was slow in preparing its investment plans (Dominica, Gabon, Grenada, and Sri Lanka).[28]

The Fund staff was not unhappy with this diversity, because it provided a welcome measure of flexibility. Reviewing the experience with Bank approvals in March 1981, a staff paper concluded as follows: "While there are clear benefits to

[25]Minutes of EBM/84/16–17 (January 27, 1984).

[26]Letter of April 6, 1984; IMF/CF (C/India/1791 "Extended Fund Facility, 1984–").

[27]"Fund Collaboration with the Bank in Assisting Member Countries," EBD/80/161 (June 9, 1980), paragraph 5 of Attachment A.

[28]"Progress Report on Fund Collaboration with the Bank in Assisting Member Countries," SM/81/62 (March 19, 1981), p. 6.

be gained by establishing such links [with Bank approval of investment programs], in some cases there may be a need for the Fund staff to adopt a more flexible approach to its operations to take advantage of these benefits." Executive Directors, not surprisingly, had mixed views. In general, creditor countries preferred to require Bank approval as a precondition for EFF arrangements, while borrowers and potential borrowers preferred more flexibility and strongly feared what they perceived as cross-conditionality. At the end of the day, the Managing Director carved out a compromise in which the general rule would be to require only a broad signal from the Bank: "In no case where there is an investment program should we engage in an extended arrangement without having an indication from the World Bank that the thrust of the investment program is in the right direction." In specific cases, however, a stronger and more specific endorsement would be required:

> Another case is one in which a country, generally a small country, has a very large project that really dominates the scene—a big hydroelectric project or very large public works project, for example. I think in that case, if we want to enter into an extended arrangement, we have to have an indication from World Bank experts that this very heavy investment seems appropriate.

Although the reference to a "small country" with a "big project" was intended as a general reference to the dependence of narrowly based economies on the success of single capital investments, the injunction closely followed and had a major impact on an application from one country in particular.

Grenada

The requirement that the World Bank certify a country's investment program created special problems when the Bank was not one of the country's creditors. In such cases, the Bank was being asked to put its own credibility at risk without any direct financial or other incentive to do so. A particularly acute problem arose in the early 1980s when this general difficulty collided against the geopolitical interests of a powerful member country. The World Bank at the time was not heavily involved with direct lending to the small island countries in the Eastern Caribbean; when Grenada applied for an EFF arrangement in 1980, it ran into unexpected problems. Although those problems were unique, the Fund's difficulties in responding to them illustrate the complexities of running a program that requires close collaboration between the two Bretton Woods institutions.

Grenada—the southern tip of the Windward Islands, a tiny country with a population of not much more than 100,000—had been a member of the Fund only since 1975, the year after it obtained its independence from the United Kingdom. Within a year, Grenada took out two stand-by arrangements within its first credit tranche and drew twice on the Oil Facility.[29] Beginning in 1977, Grenada also bor-

[29]Total indebtedness from this activity amounted to SDR 1.2 million (61 percent of quota; $1.4 million), of which SDR 0.5 million ($0.6 million) was through the Oil Facility. Under the tranche policies then in effect, the non-oil drawings (36.5 percent of quota) all counted as the first credit tranche. For footnote lovers only: the second stand-by arrangement, for SDR 225,000 ($260,000) in June 1976, was the smallest ever granted by the Fund.

rowed from the Trust Fund. In March 1979, the government that had assumed power with independence in 1974 was overthrown by the New Jewel Movement, which formed the People's Revolutionary Government. The new authorities soon applied for a stand-by arrangement (still within the first credit tranche), which the Executive Board approved in November 1979. Two developments then led the government to request more substantial support from the Fund. First, a series of major storms produced severe crop damage, especially to major export commodities such as bananas and cocoa. Second, in a bid to boost tourism, the government decided to implement a long-standing plan to build a new airport capable of handling modern passenger jets. In November 1980, a staff team headed by Samuel J. Stephens (Deputy Chief of the Caribbean Division in the Western Hemisphere Department) headed for Grenada's capital, St. George's, to negotiate terms for an EFF arrangement.

The main complication in the negotiations was that Grenada's balance of payments problem was unusual, in that it stemmed entirely from a planned increase in capital expenditures associated in substantial part with the proposed new airport. Although the EFF arrangement would not be linked directly to any project, the Fund was in effect being asked to finance Grenada's development plan. If the request had been made several years later, it might have been treated favorably as an example of "growth-oriented adjustment"; in 1980 (even accepting the economic justification of the airport), it was well ahead of its time. Nonetheless, both the staff and management readily approved the request. Although the program was considered "ambitious and unusual,"[30] the request was only for 140 percent of Grenada's modest quota,[31] and it appeared that the Fund's support could assist a troubled economy at a critical juncture. The staff report was circulated to Executive Directors, and a Board meeting was scheduled for March 27, 1981.

De Larosière's approval masked a nagging concern about the absence of an endorsement from the World Bank, which he regarded as "particularly important" in view of the central role of capital formation in the Grenada program.[32] In fact he signed off on sending the request to the Board only after he received assurances from the staff that the Bank's reticence was purely technical and only on the condition that the staff report be amended to include an explicit statement on the Bank's position. The added statement read, ". . . the World Bank is not yet in a position to endorse the investment program, and it has indicated that Grenada would

[30]Cover note by the Deputy Managing Director, William B. Dale, forwarding the staff report to the Managing Director (March 2, 1981); IMF/RD Managing Director file "Grenada, 1980–1981" (Accession 83/89, Box 1, Section 378).

[31]The rules in effect at the time permitted EFF arrangements for as much as 300 percent of quota. The interest rate, however, was higher for arrangements in excess of 140 percent, because they had to be financed partly with borrowed resources. (A subsidy scheme to alleviate the burden had been approved but was not yet operational; see Chapter 17.) The Grenadian authorities therefore decided to limit their request to the amount that could be financed entirely from the Fund's own resources.

[32]Handwritten note by the Managing Director, on the March 2 cover note referenced in footnote 30.

need to prepare a comprehensive technical and financial feasibility study of the airport complex to provide the basis for such an endorsement." After the paper was issued, the Bank staff requested—and the Fund staff and management agreed—that this sentence be strengthened. The new version, which was not circulated for the reason explained below, was to read, "The program . . . does not carry the endorsement of the World Bank, mainly because the [investment] program is dominated by a project [the airport], which, according to the information available to the Bank, was undertaken without the benefit of a technical, economic, and financial feasibility study."[33] That wording certainly would have raised eyebrows and probably would have killed the request if it had been presented to the Board.

Three days before the Board meeting, the Alternate Executive Director for the United States, Donald E. Syvrud,[34] asked management to withdraw the Grenadian request from the agenda, principally because the World Bank had not indicated its approval of the country's investment program.[35] De Larosière now realized that the Bank's reticence could not be papered over, and he consented to Syvrud's request. At first, the meeting was merely to be postponed, and the staff were divided on whether to try to resuscitate the proposal. Within a few days, however, the Managing Director decided not to go ahead with the EFF arrangement but to try to persuade the authorities to accept a 12-month stand-by arrangement for a smaller amount (i.e., smaller than the first year of the abandoned three-year program).

The Grenadian authorities reacted with bitter vehemence. The finance minister, Bernard Coard, threatened to take his request directly to the Interim Committee and even to withdraw from Fund membership if the EFF arrangement was not eventually approved. Stephens was hastily dispatched to St. George's with a personal message from de Larosière, and a compromise was soon reached under which the full amount of the original first-year program would be approved (the equivalent of 76 percent of Grenada's quota), but only as a 12-month stand-by arrangement. The Executive Board then met on May 11 and approved the request over the objections of the United States.[36] De Larosière and Coard met 10 days later in Libreville, Gabon, in the margins of the Interim Committee meeting. Afterward, Coard—a U.S.-educated and highly competent economic manager but an advocate of extreme leftist political views—held a press conference to say that his quarrel was not with the Fund: it was with the United States, for politicizing the institution.

[33]The staff report, as circulated, was "Grenada—Use of Fund Resources—First Credit Tranche, and Request for Extended Arrangement," EBS/81/55 (March 13, 1981). The first revision was based on a March 11 memorandum from Sterie T. Beza to the Managing Director; the intended second revision was to be based on a March 25 memorandum from Walter E. Robichek to the Managing Director; IMF/RD Managing Director file "Grenada, 1980–1981" (Accession 83/89, Box 1, Section 378).

[34] The Executive Director position was vacant. Sam Cross had resigned in January, and Richard Erb did not take up the position until July.

[35]Syvrud's oral request was made privately, but he later explained his rationale at EBM/81/79 (May 11, 1981).

[36]Minutes of EBM/81/79 (May 11, 1981).

This contretemps would have signified little had it not been a gambit in a much larger game. At the same time that the U.S. authorities were asking the Fund to withhold the EFF arrangement from Grenada, they were asking the European Communities not to provide financial support for the airport. The airport itself had little relevance for the Fund (and none at all for the World Bank), because most of its cost was being paid for by foreign grants. Those grants, however, were coming not only from the former colonial power (Great Britain), its European allies, and Grenada's closest mainland neighbor (Venezuela), but also from such nontraditional and far-flung benefactors as Cuba (which also was providing much of the labor), Iraq, Libya, and Syria. The source of financing was of no matter to the Fund, but it was to the U.S. government. Building an international airport as a foundation for tourism had been a Grenadian goal since before independence, but the U.S. administration in 1981 saw it as a potential base for Cuban military intervention in Angola, Ethiopia, and possibly in the Western Hemisphere.

The final drawing under the stand-by arrangement was eventually disallowed when no agreement could be reached on fiscal targets for the first quarter of 1982. Negotiations on a replacement program then dragged on throughout 1982. The World Bank continued to refuse to endorse the investment program, and Coard continued to press the case that Grenada was being subjected inappropriately to cross-conditionality between the two Bretton Woods institutions. Finally, after several negotiating sessions in St. George's and in Washington, agreement was reached on a three-year EFF arrangement for SDR 13.5 million ($14 million, or 300 percent of quota). Erb opposed the request at the August 24 Board meeting, and he was joined by three other Directors: from Germany, the United Kingdom, and the Netherlands. The Dutch Alternate Director, Tom de Vries, argued that the economic program was too weak to justify such large and extended support, and he moved to amend the proposal by again substituting a one-year arrangement. The majority of the Board, however, approved the full EFF arrangement.[37]

Tragically, Grenada was to make only one drawing under the EFF. On October 19, 1983, while a Fund mission was in St. George's reviewing implementation of the program, the government was overthrown in a violent coup aimed at installing Coard as prime minister. The Organization of Eastern Caribbean States, fearing that the coup would advance expansionist plans of the Soviet Union and Cuba in the region, asked the United States to intervene militarily. Despite widespread pleas to the contrary, including from the British government,[38] President Reagan sent U.S. forces to invade Grenada on October 25—the day after the Fund mission was finally evacuated. Coard and other coup leaders were captured and imprisoned. The new government would face massive rebuilding problems, and for now the Fund had no alternative but to cancel the EFF arrangement and wait for better times.

[37]Minutes of EBM/83/121–122 (August 24, 1983).

[38]See Thatcher (1993), pp. 328–33, for the British perspective.

Death and Rebirth of the EFF

No sooner had the Fund begun to succeed in encouraging countries to take advantage of the larger and longer-term resources of the EFF than it began to have second thoughts. As early as 1980, the staff expressed concerns that programs were being approved in cases where the authorities had done no more than the minimum to correct the course of economic policy and had not developed a plan to revitalize growth over the longer term. For the January 1981 review of the operation of the facility, the staff proposed—and the Board agreed—that the criteria for qualifying for an EFF arrangement should be applied more rigorously: countries should be required to put forward a "program with a clearly delineated adjustment path for a medium-term period."[39] That injunction had little direct impact, first because several extended arrangements were already in the pipeline and later because the international debt crisis made large extended arrangements essential, especially for the two most heavily indebted countries, Brazil and Mexico. (As discussed in Chapter 9, Argentina—the third largest—could not develop a medium-term program because it was in the middle of a transition from military to democratic rule.) After 1983, however, the Fund began scrutinizing potential EFF cases much more closely, and few countries were willing even to consider asking for extended arrangements. One-year stand-by arrangements again became the norm, even if they had to be repeated annually to enable borrowers to cope with deep-seated problems. During a period of nearly five years, between September 1983 and June 1988, the Fund approved only two extended arrangements: for Chile, in August 1985, and for Ghana, in November 1987.

Throughout the middle 1980s, the prevailing view in the Fund (and outside; see Killick, 1984, pp. 209–10) was that the EFF had little if any role to play. The gradual liberalization of access terms for stand-by arrangements had given countries a continuum of options, ranging right up to the three-year programs and large size of EFF arrangements. As the economic policy programs supported by stand-by arrangements became more structural and as the specification of medium-term objectives and plans became more nearly universal, the distinction between stand-by and extended arrangements became difficult to discern. The 1985 EFF arrangement for Chile was based on a quite standard set of policy intentions designed to "reduce the external current account deficit, achieve moderate economic growth, and lower inflation."[40] Moreover, low-income countries—a major segment of the original target clientele for the facility—now had a much more attractive alternative in the Fund's concessional lending arms, the structural adjustment and enhanced structural adjustment facilities (SAF and ESAF). As explained in Chapter 14, the EFF arrangement for Ghana was canceled after its first year and replaced by an ESAF arrangement on more favorable terms.

[39]"Review of the Extended Fund Facility," SM/80/278 (December 29, 1980), p. 19.

[40]"Chile—Staff Report for the 1985 Article IV Consultation and Request for an Extended Arrangement," EBS/85/122 (May 13, 1985), p. 14.

What breathed new life into the EFF was the need to resuscitate the international debt strategy in 1988. By then, the 1985 Baker Plan had failed, and the Fund was searching for a means to promote growth more seriously in heavily indebted countries. It was still too early to deal directly with the huge stock of outstanding debt, but the time had come for one last effort to find a way for countries to grow out of their debt.

The Executive Board agonized over whether and how to revitalize the EFF, holding four days of meetings on the subject during the first half of 1988.[41] If the facility still had a role, it had two aspects: credits should be larger than those available under ordinary stand-by arrangements, and programs should include deeper structural reforms. The first dimension raised questions of financial prudence, and the second raised questions of the Fund's mandate and competency. Finally, the Board agreed to make three modest changes, which taken together would carve out a niche for new extended arrangements.

First, the Board agreed informally to approve somewhat larger credits within the existing access limits. The two EFF arrangements approved in the preceding five years had been small in relation to the maximum credits the Fund could have extended, and everyone agreed that this trend should be reversed. However, the Board rejected a management proposal to raise the access limits. Arguing for an increase in the three-year ceiling from 270 percent of quota to 330 percent, the Managing Director, Michel Camdessus, noted that net lending by the Fund had been negative for the past two years. Continuing that pattern would not be "an appropriate stance for the Fund at this juncture," and the most effective way to reverse it would be to raise the ceilings.[42] Directors generally accepted the goal but preferred to be cautious in pursuing it.

Second, the Board agreed that countries could get a fourth year of access. The Board still would approve only three-year credits, but once a track record was established, the borrower could apply for an extension.[43] This change introduced two types of flexibility. In one case, if a program went temporarily off track and disbursements were delayed, the original arrangement could be stretched into a fourth year to allow the country to make all of the scheduled drawings. In another, if a reform program was going well, the borrower could apply to augment the original arrangement, with additional drawings in the fourth year. To satisfy Directors who were worried that augmentation requests might get out of hand, this change was linked to the decision mentioned above not to raise the access limits. In other

[41]Minutes of EBM/88/23–24 (February 22, 1988), EBM/88/46–47 (March 24, 1988), IS/88/1 (March 31, 1988), and EBM/88/89 (June 6, 1988).

[42]Minutes of EBM/88/46 (March 24, 1988), p. 4. For background on the issue, see "Reconsideration of the Extended Fund Facility," EBS/88/7 (January 20, 1988), pp. 16–17. For a table showing actual access in EFF arrangements through 1987, see "Reconsideration of the Extended Fund Facility—Selected Aspects of the Experience with Extended Arrangements," EBS/88/7, Sup. 1 (January 27, 1988), p. 13.

[43]The staff proposal was to allow initial approval of four-year programs. When several Directors objected, the idea of allowing extensions emerged as a compromise. See "Reconsideration of the Extended Fund Facility," EBS/88/7 (January 20, 1988), pp. 12–14.

words, countries could get an extra year's money a little more easily than before, but the cumulative ceiling on how much they could borrow was unchanged.

Third, the Board changed the "mixing ratio" that specified how much of an arrangement was from borrowed rather than the Fund's own resources to make EFF credits a little less expensive. Instead of lending equal amounts of own and borrowed resources up to 280 percent of quota, the Fund would first lend up to 140 percent using its own resources before the borrowed money would kick in.[44] Since the borrowed resources carried a higher interest rate and had to be repaid more quickly, the total cost of servicing the credit was expected to fall. In the event, however, a subsequent drop in the cost of the Fund's borrowings pushed the rate charged on borrowed resources below the Fund's own rate of charge, so the intent of this change was frustrated.

Not surprisingly, this minor liberalization did not immediately lead to a long queue of applications. For all of 1988, only one new EFF arrangement was approved. In July, the Board agreed to lend Tunisia SDR 207.3 million ($270 million; 150 percent of quota), an amount that eventually was fully drawn over four years. The real revitalization came in the spring of 1989, when the Fund sprung into action to support the Brady Plan. To qualify for the extra funds dedicated to paying for debt reduction, borrowers had to submit a medium-term reform program under the terms of the EFF. As recounted in Chapter 11, the Board approved three EFF arrangements (to Mexico, the Philippines, and Venezuela) in quick succession in May and June, totaling SDR 7.2 billion ($9 billion). Two of the three later were augmented and extended into a fourth year, and the Fund's total commitment under the three arrangements rose to SDR 8.2 billion. (Of that, SDR 1.9 billion was earmarked for debt reduction.)

Throughout the next several years, the EFF was a moderately active facility for Fund lending, partly because of a continuing flow of Brady deals and partly because of an increased willingness by many developing countries to commit themselves to longer-term policy programs. From May 1989 through April 1996, the Fund approved 19 new EFF arrangements (10 percent of total arrangements) for a total commitment of SDR 25.2 billion (36 percent of total commitments). For most of that time, until the large stand-by arrangements for Mexico and Russia took effect in 1995–96, credit outstanding under EFF arrangements averaged about one-third of the total stock of Fund credit. The EFF had had a bumpy ride through its first two decades, but it finally had found its place in the Fund's arsenal.

Compensatory and Contingency Financing

When the Compensatory Financing Facility (CFF) was established in 1963, it was an important and controversial response to a serious economic problem that afflicted many countries in almost every region of the globe. A 1960 staff study

[44]This change also was a compromise. The original staff proposal was to raise the access limit on the Fund's own resources to 200 percent of quota.

confirmed what many observers had long suspected: for the developing world, fluctuations in the prices of primary commodities were a particularly large and intractable source of the current account deficits that led them to seek the Fund's financial assistance. Specifically, the staff found that commodity prices had a higher variance than industrial prices and that countries whose exports were predominantly commodities experienced greater fluctuations in their current account balances than did countries with diversified or heavily industrial exports. A case therefore could be made that temporary financing to compensate for these fluctuations would be more appropriate than requiring countries to tighten their belts and wait for better times.

After lengthy soul-searching over the wisdom of weakening the institution's conditionality, the Fund responded by establishing special procedures for providing larger credits and making arrangements easier to obtain for countries facing a temporary shortfall in export revenues because of circumstances beyond their control.[45] As originally designed, the CFF enabled arrangements to be larger by giving borrowers access to more than 100 percent of their quota (for regular and CFF credits in the aggregate), although only 25 percent of quota could be in this form. Moreover, it provided both for faster consideration of requests than under the procedures for stand-by arrangements, with lower conditionality, and for immediate rather than phased disbursements. The Fund, however, explicitly rejected proposals to make access to the facility automatic for countries with export shortfalls.[46]

By the 1990s, after thirty years of experience and many revisions, the CFF had become the Compensatory and Contingency Financing Facility (CCFF) but essentially had been stripped of its usefulness. Jacques Polak, who as an Executive Director in the 1980s had fought to retain a role for the facility, concluded in 1991 that it "is only a slight exaggeration . . . to say that the CFF has ceased to exist as a special facility in the Fund" (Polak, 1991, p. 10). At the apex of CFF activity in FY 1983, 29 countries drew a total of SDR 3.7 billion ($4.1 billion; 36 percent of all lending from the Fund's general accounts). Usage then dropped off sharply (Figure 15.2). By 1989–90, only three countries drew on the facility, borrowing SDR 0.8 billion ($1.1 billion; 18 percent of the total).

A smoothed sketch of the rocky history of the CFF shows that from 1966 through 1979, the facility was gradually liberalized until it became a major channel for Fund lending. In 1983, concerns about the overall weakness of the Fund's conditionality led Executive Directors to toughen conditions for compensatory financing quite severely. Beginning in 1988, various changes were introduced at the margin that were intended to resuscitate the facility but did not succeed.

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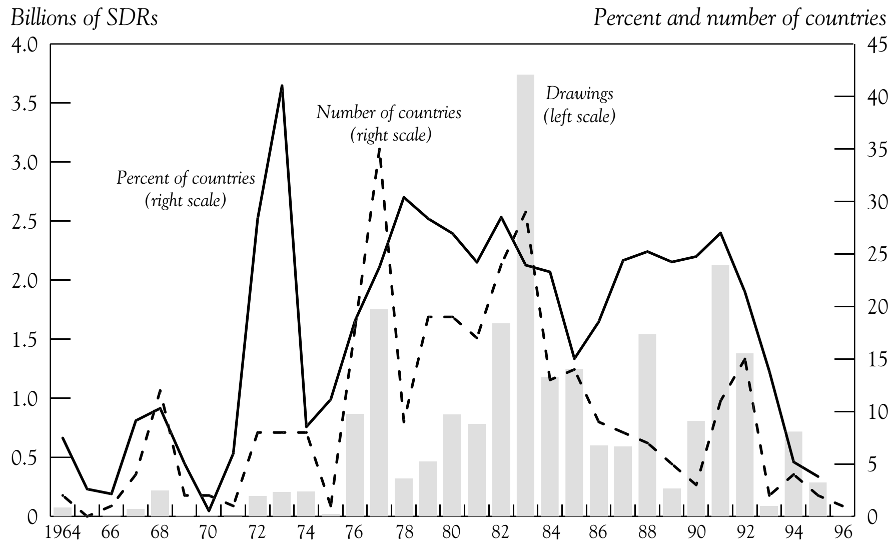
[45]Although the intention was to provide credits to exporters of primary commodities, the facility covered overall shortfalls in revenues from the export of primary or manufactured goods.

[46]For the background on the creation of the facility, see Horsefield (1969), Vol. 1, pp. 531–36, and Vol. 2, pp. 417–27. The Executive Board Decision establishing the facility is reproduced in Vol. 3, pp. 238–40. The motivating staff study was published in *IMF Staff Studies*, Vol. 8 (November 1960), pp. 1–76. For a firsthand recollection of the political negotiations preceding the creation of the facility, in which the United States decided to support a proposal that was opposed by European governments, see Dale (1994), pp. 20–21.

Figure 15.2. CFF and CCFF: Drawings, 1964–96



Note: Percent of countries is a three-year moving average.

Liberalization, 1966–79

During the first three years after the CFF was established, only three countries took advantage of it. Demand was limited because most commodity prices were strong in the mid-1960s, but potential borrowers also were discouraged by the lending limits. In anticipation of a growing potential demand, the Executive Board liberalized the facility in September 1966 by doubling the cumulative lending limit from 25 percent of quota to 50 percent and by creating the principle of "floating" access. "Floating" meant that borrowing on this facility was treated as independent from borrowings under the Fund's ordinary tranche policies. Before the change, a country with no previously outstanding obligations that borrowed the equivalent of 25 percent of its quota under the CFF rules would then have been subject to full conditionality if it wanted to borrow any more from the Fund. After the change, it could borrow another 25 percent through the CFF *and* would still have its first credit tranche available for a regular low-conditionality arrangement.[47]

From the beginning, the biggest concern of CFF skeptics was that countries that needed to tighten their macroeconomic policies would postpone the inevitable adjustment by relying on compensatory financing from the Fund. That concern was recognized in the official report that the Executive Board approved when it estab-

[47]Similarly, if the country had not drawn against its gold tranche, it could borrow through the CFF while leaving its gold tranche intact. The 50 percent limit on cumulative outstanding obligations under the CFF was combined with a 25 percent limitation on drawings in any 12-month period, and the second 25 percent was subjected to a higher level of conditionality. For a more detailed discussion of the 1966 liberalization, see de Vries (1976), Vol. 1, pp. 261–68.

lished the facility in 1963. The report argued that temporary export shortfalls and policy inadequacies were independent phenomena, either of which could lead to a balance of payments problem. The new facility would deal with the former, while the Fund's general tranche policies would continue to deal with the latter. However, *any* proposed drawing, including a CFF credit, that would take the country's obligations above the first credit tranche would trigger an evaluation by the Fund "that a sound set of policies is being followed" (Horsefield, 1969, Vol. 3, p. 447). In other words, the CFF was not to be used to avoid Fund conditionality. Operationally, the rule was that a borrower was expected to "cooperate with the Fund in an effort to find, where required, appropriate solutions for its balance of payments difficulties" (Horsefield, 1969, Vol. 3, p. 239).

When the facility was liberalized in 1966, an additional requirement was introduced for CFF credits above 25 percent of quota. Besides the expectation that the country would cooperate in finding a solution to its problems, the Fund now had to determine that a borrower had already met the test of cooperation with respect to its earlier credits (de Vries, 1976, Vol. 2, p. 199). That is, when a country requested a CFF credit equivalent to 25 percent of its quota, the Fund might ask the authorities to submit a statement of intentions on how they proposed to adjust their macroeconomic policies to put the balance of payments on a sustainable course. If the country requested a second CFF credit a year or so later, the Fund would review the extent to which those policy intentions had been carried out before approving the request.

The 1966 changes stimulated usage of the CFF, even in periods when primary commodity prices were not especially weak. During the 1972–74 boom in commodity prices, more than 40 percent of all Fund lending was to compensate for calculated temporary shortfalls in commodity export receipts.[48] When commodity prices declined anew in 1975, the Fund again turned its attention to a liberalization of the CFF as a way to provide quick but targeted assistance to afflicted countries. In December of that year, the Executive Board agreed to raise the lending limit again, to 50 percent of quota in any year and 75 percent cumulatively; and to introduce some technical modifications designed to cut the lag between a drop in export revenues and the Fund's approval of a credit.[49] These apparently minor changes ushered in a liberality of application that produced an explosion of borrowings over the next two years. Then, in 1978 and 1979, usage dropped off again, owing principally to a renewed cyclical rise in commodity prices.

[48]This anomaly resulted partly from the inevitable lag between the actual shortfall and the approval of the credit, and partly from declines in certain commodity prices even while others were rising. The three largest CFF credits in 1972–74 were to Argentina, Bangladesh, and India, which together accounted for nearly one-third of the total. The March 1972 Argentine credit compensated for shortfalls in beef and wheat exports during 1971, which resulted from normal cyclical shifts in production and from adverse weather conditions. The December 1972 credit to Bangladesh compensated for a drop in jute exports during the 12 months through June 1972, which resulted from floods, cyclones, and the 1971 war of independence. The February 1974 credit to India compensated for an overall shortfall in a wide range of exports in the year through mid-1973, some of which (notably jute products) had declined in price during the general boom period.

[49]For the details of the 1975 changes, see de Vries (1985), pp. 399–413.

The third major liberalization came in 1979, at a time when oil-importing developing countries were reeling from the opening moves in the second oil shock. In fact, for several years the governments of concerned industrial countries had been advancing a variety of proposals to compensate developing countries more fully for unavoidable shocks to commodity prices or volumes. In September 1975, the U.S. government tabled a proposal to subsidize CFF credits for low-income countries and to dedicate a portion of Trust Fund resources to compensate eligible countries for declines in the prices of specific commodities. In March 1977, the Swedish government made a similar proposal and suggested somewhat broader coverage. In September 1978, the German government suggested establishing a separate loan fund (outside the IMF) to stabilize developing countries' aggregate earnings from primary commodities and to subsidize loans for the poorest countries.[50] The thrust of these proposals was endorsed by the Group of 77 developing countries and by the Development Committee, and the United Nations Conference on Trade and Development (UNCTAD) initiated a work program aimed at establishing a separate fund along the lines of the German proposal. The Fund staff then responded with a scheme to achieve the basic objectives within the IMF by further expanding the role of the CFF.

As often happens, the staff proposals focused on arcane technical issues, while the effects of the proposed changes had major economic and political implications. The issues included whether to use geometric rather than arithmetic averages of yearly data to calculate temporary shortfalls and whether to make a separate calculation of shortfalls on a list of specified commodities. Though technical in nature, both issues affected whether credits would go primarily to low- or middle-income countries.[51] Several Executive Directors reacted quite negatively and with unusual vehemence to the proposed changes. Robert J. Whitelaw, whose country (Australia) had borrowed the most money from the CFF up to that time but stood to lose under the proposed revisions, suggested that "the staff had ridden rather roughshod over some basic Fund principles" in trying to skew the calculations in

[50]The U.S. proposal was introduced at the Fund by the U.S. Executive Director, Sam Y. Cross, during the 1975 CFF review. The Swedish proposal was circulated as a Working Paper of the Royal Ministry of Foreign Affairs (March 31, 1977). The German proposal was circulated as a background paper for the Development Committee meeting of September 6–7, 1978. For summaries of all three proposals, see "Possible Changes in the Compensatory Financing Facility—Annexes I, II, and III," SM/79/24, Sup. 1 (January 23, 1979). The German proposal was circulated at the Fund as "Stabilization of Export Earnings," EBS/78/506 (September 13, 1978).

[51]The basic methodology for calculating a shortfall was to compare merchandise export revenues in the base year with a computed five-year trend, using forecasts for the future years. With an arithmetic average, the trend value was $\overline{X} = (\sum X_i)/5$, $i = t{-}2, \ldots t{+}2$. The geometric average used logarithms instead of levels. (For more detailed calculations, see Appendix I to this chapter.) The rationale for using logarithms was that if merchandise export revenues grew at a constant percentage rate, the revised methodology would show a zero shortfall from the calculated trend, whereas the arithmetic average would lie below the calculated trend. Empirically, export revenues for low-income countries tended to have relatively high cyclical rather than trend components. Consequently, switching from arithmetic to geometric averaging would reduce calculated shortfalls more for middle-income (trend-dominant) countries than for low-income (cycle-dominant) countries. For an explanation and illustrative calculations, see "Possible Changes in the Compensatory Financing Facility—A Preliminary Paper," SM/79/24 (January 19, 1979), pp. 6–8.

favor of developing countries. H. Onno Ruding (Netherlands) complained that the staff proposals "would lead to a deliberately arbitrary, discriminatory and unfair shift in eligibility." He favored providing additional support for low-income countries, but not by taking it away from middle-income developing countries.[52]

The Board met several times on these issues from February through April 1979, without resolution. Similarly, an UNCTAD meeting in Manila in May produced no consensus on whether a separate compensatory fund should be established independently from the IMF: an outcome that both the Fund staff and most industrial country governments were quite happy to avoid.[53] Finally, the Executive Board decided in August to keep the basic structure and operation of the CFF unchanged but to liberalize the access rules further. Once again, the lending limits were raised: from 75 to 100 percent of quota, with no sublimit on annual access (previously 50 percent).[54] Moreover, for the first time applicants were permitted to include declines in tourism revenues and in workers' remittances in calculating the shortfall.[55] That change helped several (mostly small) countries to qualify for credits despite a lack of dependence on exporting primary commodities. To improve the timeliness of CFF credits, the Board authorized the staff to use estimated data for calculating shortfalls, with the proviso that drawings would have to be promptly repurchased if the estimates turned out to have been overstated.[56] These various expansions were to be

[52]Minutes of EBM/79/18 (February 6, 1979), pp. 3 (Whitelaw) and 9–10 (Ruding).

[53]Two other compensatory funds already existed, aside from the CFF: STABEX, administered by the European Economic Community since 1975, and a scheme established by the Arab Monetary Fund in 1978 to provide financing for its members as a supplement to the CFF.

[54]Gradually increasing the lending limit from 25 percent of quota in 1963 to 100 percent in 1979 did not result in an equally large increase in the portion of export shortfalls compensated by CFF credits, mainly because quotas grew less rapidly than world trade and many countries remained constrained by the ceilings. With the 75 percent quota limit in effect for 1976–79, countries borrowing through the CFF were compensated on average for approximately 50 percent of their calculated export shortfall. With the higher limit in place in 1980–82, the compensation ratio rose to a little over 60 percent. For the 1976–82 compensation ratios, see "Compensatory Financing Facility and Buffer Stock Financing Facility—Review of Experience with Financing Fluctuations in the Cost of Cereal Imports and Selective Policy Issues," SM/83/131 (June 16, 1983), p. 14, fn. 2.

[55]To prevent countries from using data selectively to overstate the case for compensation, this decision specified that if a country chose to include tourism or worker's remittances, it had to continue to do so for the next five years. For the full text of the decision, see *Annual Report 1980*, pp. 136–38.

[56]The general early-repurchase requirement was introduced in 1975, as part of a reform that permitted borrowers to use estimated data for up to six months of the "shortfall year" for export revenues. See de Vries (1985), pp. 409–10. Throughout the 1980s, with the aid of estimated data, some 85 percent of CFF credits were approved within six months of the initial request. In several instances, countries were asked to repay part of the principal early on the basis of revised data. In most cases, that process worked without difficulty. The few exceptions involved countries that were experiencing difficulties staying current on their obligations to the Fund. Notably, in August 1981, the Fund determined that Sudan had to make an early repayment on a CFF drawing, but Sudan asked for a delay on the grounds that it lacked the money. The Managing Director proposed to reschedule the repayment over a period of 2–4 years, subject to lapse-of-time approval by the Executive Board. Ariel Buira (Mexico) objected that the Fund had never before rescheduled an overcompensation repayment, and he called for a meeting. The Board met in October to discuss the proposal and decided to allow only a six-month delay. No general policy was ever formulated on overcompensation delays, because the CFF decision did not give rise to a legal

partially offset by acceptance of the staff recommendation to switch to geometric averaging, which most believed would help to weed out inappropriate credits.

With the extension of the upper lending limit to 100 percent of quota, the Board retained 50 percent as the limit for the "lower tranche," beyond which an applicant would have to demonstrate that it had been cooperating with the Fund to find a solution for its balance of payments problems. In most such cases, the experience had been that countries with that large a problem also had stand-by arrangements in effect, which provided a ready test of cooperation. In the few exceptions, the staff was satisfied that the country could have qualified for a stand-by arrangement at least in the first credit tranche. Therefore, the staff proposed in 1978 that the Fund adopt that standard—first credit tranche conditionality—as a formal test for access to the "upper tranche" of the CFF. Executive Directors, however, rejected that idea as too rigid: if the purpose of the CFF was to compensate for export fluctuations, then the facility should be administered flexibly, and a formal conditionality test would unnecessarily complicate the evaluation of requests.[57]

Throughout the life of the CFF, the Fund applied a liberal interpretation of the condition that an export shortfall must arise largely from "circumstances beyond the control of" the authorities. Political disturbances and wars were obviously matters that the authorities could control, but often only if they were prepared to sacrifice social and political objectives. In April 1982, the Fund acknowledged and reaffirmed that "the question whether a political disturbance could have been avoided is one that the Fund does not address in its relations with members, and consequently, the practice has been to regard shortfalls resulting from such disturbances as being outside the control of the member." This agreement effectively prevented opponents from objecting to CFF requests such as that of Argentina after the war with the United Kingdom, as discussed in Chapter 8.[58]

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obligation for borrowers to make early repayments. On the Sudan case, see "Sudan—Compensatory Financing Facility—Repurchase under Paragraph 7 of the 1979 Decision" EBS/81/166 (August 7, 1981); "Sudan—Rescheduling of Repurchase," EBS/81/208 (October 19, 1981); and minutes of EBM/81/134–135 (October 30). Additional background materials may be found in IMF/CF (C/Sudan/1750 "Repurchase Obligations, 1979–1984") and IMF/RD Managing Director file "Sudan, 1981" (Accession 83/108, Box 3, Section 376).

[57]"Stabilization of Export Earnings," SM/78/139 (May 23, 1978), p. 31; minutes of EBM/78/93–94 (June 26, 1978); and "Text of Managing Director's Summing Up as Agreed at EBM/78/115 (7/21/78)." Also see "Review of the Compensatory Financing Facility," SM/79/4 (March 15, 1979), pp. 4–6 and 19. Under the terms of the First Amendment of the Articles of Agreement, *all* Fund lending beyond the Gold Tranche had to be conditional rather than automatically available. The issue concerned whether the Fund should specify a particular type or degree of conditionality.

[58]Political disturbances were frequently noted by the staff as one contributing factor leading to requests for CFF drawings, but they were rarely the dominant factor. The clearest case cited in the 1982 review was a July 1981 drawing by El Salvador. In that case, the ongoing civil war between the ruling military junta led by José Napoleon Duarte and leftist guerrilla groups resulted in a sharp decline in export volumes. Even though the staff was unable to forecast exports in those circumstances, the Board agreed that the situation was beyond the authorities' control and approved the request. See "Compensatory Financing Facility—The Meaning of 'Shortfall Attributable to Circumstances Beyond the Control of the Member,'" EBS/82/42 (March 12, 1982), pp. 10–11 and 24–25; and minutes of EBM/82/41–42 (April 5, 1982).

Financing for Food, 1981

The next couple of years saw a continuing flow of financing through the CFF, in amounts that were substantially larger than would have been possible under the pre-1979 rules.[59] Meanwhile, attention turned to a related problem: the increased volatility of food prices in the 1970s, which was creating severe difficulties for many developing countries—especially the poorest—in paying for imports that were needed to feed the population. A 1978 staff paper proposed treating certain food imports as negative exports for purposes of calculating net export shortfalls, but the idea foundered in the Executive Board over concerns that it was inappropriate for the Fund to single out food imports as a balance of payments problem. (If, to tackle the other main issue of the time, fuel imports were also covered, demands on the facility could have become overwhelming.)[60] A few months later, however, the World Food Council and the Food and Agriculture Organization (FAO) of the United Nations asked the Fund to consider establishing a parallel facility to compensate developing countries for temporary increases in the cost of imported food. On receiving the request, the Executive Board agreed to reconsider the idea.[61]

Interest in the idea of a new food facility intensified in 1980, especially after the highly publicized report of the Brandt Commission took up the cudgels (Brandt Commission, 1980, pp. 217–18). De Larosière took a strong interest in the proposal and took extraordinary measures to soften potential opposition by Executive Directors. Three days before the Board was scheduled to discuss the issue in August 1980, he made an impassioned plea to Directors to look well beyond the Fund's usual preoccupations with short-term financial issues. He began in a Malthusian vein by noting that the world's population was expected to grow from 4.4 billion to 6 billion in the next 20 years, a fact that was "one of the most important . . . that any decision-making institution or person should have permanently in mind." Because of that explosion, "the food problem . . . will be one of

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[59]One year after the 1979 revisions went into effect, the staff calculated that actual drawings in that year would have been reduced by more than half without the liberalization, primarily owing to the elimination of the ceiling on access within a given year. The switch to geometric averaging had a negligible negative impact. "Recent Developments in Programs of Export Earnings Stabilization," SM/80/182, Rev. 1 (August 5, 1980), p. 5. For a detailed description and analysis of how the facility worked after the 1979 revision, and for a complete list of CFF credits from 1963 through March 1980, see Goreux (1980).

[60]"Stabilization of Export Earnings," op. cit., pp. 24–27, and associated minutes and documents cited in footnote 57, p. 729.

[61]The World Food Council's request was included in a report on "World Food Security for the 1980s," adopted in April 1979. In May, the FAO Council adopted a "Plan of Action on World Food Security" in May, which invited the IMF "to consider within the context of its Financing Facilities the feasibility of providing additional balance of payments support for meeting the rise in food import bills of low income food deficit countries, particularly in the event of domestic food shortages and rising import prices" (FAO, 1979, p. F-2). The Director-General of the FAO, Edouard Saouma, formally transmitted the request to the Managing Director in June. "FAO Proposal to the International Monetary Fund," EBD/79/182 (July 17, 1979), and Sup. 1 (July 18). For supporting material, see (under the same title), EBD/80/18 (January 17, 1980). For the Fund's response, see minutes of EBM/79/126 (July 25, 1979).

the main challenges to the survival of man." The Fund, he continued, could not and should not try to solve the problem of how to feed the growing masses in impoverished countries, but it could try to deal with the "much narrower problem . . . of trying to maintain consumption levels in these poorer countries in the face of real but reversible increases of food imports." Finally, he asked the Board "to give weight to the human considerations which are associated with this issue" and to approach the FAO's request with "a considerate, cooperative attitude."[62]

The Executive Board discussed the FAO request on three days of meetings in August and early September 1980, at the end of which a consensus emerged in favor of some mechanism for financing food imports. What remained was a battle over whether and how the proposed financing should be integrated with the existing CFF. That question was not just a technical matter of bureaucracy; at its heart, it was a question of how much money should be put on the table. With a new and separate facility, the Fund would extend credits to cover the cost of a temporary surge in the cost of importing food, regardless of what the borrower's overall trade balance was doing. Alternatively, if the scheme were fully integrated into the CFF, the Fund would provide food-import credits only if the country had a net shortfall in merchandise exports minus food imports. Between these extremes, consideration also was given to "partially integrated schemes," in which countries could borrow either for import excesses or export shortfalls, but with linked limits on the amounts that could be borrowed.[63]

Those favoring a greatly limited scheme did so for a variety of reasons. Bernard J. Drabble (Canada) noted that his Canadian authorities were worried about devoting resources to a "piecemeal approach to balance of payments problems," while the authorities in the small Caribbean island states that he also represented were concerned about the Fund lending money for food imports but not for other emergencies resulting from hurricanes and other natural disasters. Ruding expressed concerns about overlapping with the functions of development banks, which could lead to "double compensation." Heinrich G. Schneider (Alternate—Austria) worried about "stretching or bending the Fund's Articles of Agreement" by lending for problems other than a general balance of payments deficit. Jahangir Amuzegar (Iran) wondered how the Fund, if it approved the FAO request, could possibly refuse a hypothetical request for, say, a "health facility" from the World Health Organization.[64] Nonetheless, the widespread recognition that low-income countries faced a potentially disastrous situation, coupled with the personal persuasion of the Managing Director, carried the day. The Interim Committee endorsed the general idea at its September 1980 meeting and asked the Executive Board to develop a specific proposal.

What finally emerged after several months of further meetings was a scaled-down and partially integrated scheme: a new window within the CFF to compen-

[62]Minutes of EBM/80/117 (August 1, 1980), pp. 3–6.

[63]"Possible Assistance to Members Adversely Affected by Higher Food Import Costs," SM/80/264 (November 26, 1980).

[64]Minutes of EBM/80/130 (September 4, 1980), p. 7 (Ruding), p. 8 (Drabble), p. 9 (Schneider), and p. 10 (Amuzegar).

sate countries for temporary increases in the cost of importing cereals (principally wheat, maize, and rice). The idea was to treat the cost of importing these foods as negative exports and to give countries both an extra means of qualifying for a CFF credit and a further small increase in the overall lending limit. A country with no shortfall in merchandise exports but with a surge in the cost of food imports could now apply for a credit of up to 100 percent of its quota through the new "cereals window." A country with a shortfall in exports could continue to apply for a credit of up to 100 percent of quota, as before. And a country with both problems could apply for credits under both windows, subject to an overall limit that was now raised to 125 percent of quota.[65]

These percentages represented a carefully constructed compromise, on which the Board was able to break a deadlock on May 13, 1981, only because Directors were eager to avoid throwing the matter into the hands of the Interim Committee. The committee was scheduled to meet the next week in Libreville, Gabon, and it almost certainly would have recommended at least as large a facility as the one approved by the Board. An extra complexity was introduced in the solution to cover cases in which countries might have (or expect to have) a shortfall in both exports and imports. Under the 1981 decision, if a country had below-trend cereal imports in the same year in which it had below-trend exports, the drop in import costs would be deducted from the export drop to derive a net export shortfall. To avoid penalizing countries in that situation, the option of applying under the 1979 rules (on the basis of the gross shortfall) was retained, and countries choosing that option could still use the cereals window later if necessary. However, once a government chose to borrow under the terms of the 1981 decision, the country was barred from using the 1979 rules for the next three years.[66]

As it happened, the cereals window got very little usage in the 1980s because the cost of importing cereals generally declined after the facility was established. The flip side of the depressed state of world markets for primary commodities in the 1980s was that basic foods were more globally plentiful than before; the problem for most developing countries was the value of exports, not the cost of imports. Consequently, in the first six years of operation (through April 1987), the Fund lent SDR 8.2 billion under the terms of the 1979 rules on compensating for gross export shortfalls, SDR 0.6 billion under the 1981 rules on net export shortfalls, and SDR 0.5 billion for excess cereal imports. Only seven countries borrowed for cereal imports during that period, in amounts ranging from 4 to 59 percent of quota.[67] In all cases, the excess imports resulted from bad weather conditions that

[65]In January 1984, after the quota increases under the Eighth General Review came into effect, the CFF lending limits were reduced to 83 percent for each window and to 105 percent for the two windows combined. Since quotas had risen on average by 47.5 percent, the effect was to raise the lending limits in terms of SDRs by 22–24 percent. For the context of that decision, see the discussion of access policies in Chapter 17, pp. 875–84.

[66] For the Decision establishing the cereals window and a few illustrative examples of how these provisions were intended to work, see Appendix I.

[67] The seven countries borrowing for cereals imports through April 1987 were Bangladesh, Ghana, Jordan, Kenya, Korea, Malawi, and Morocco.

cut domestic production and forced countries to import larger quantities of food. In all cases but one (Jordan), these countries also had stand-by arrangements in effect.[68] Some countries that were hit hardest by adverse weather, including much of the African region that suffered from drought and famine in the mid-1980s, either could not afford to take on new debts or could not meet the standards for financial assistance from the Fund.

In the next three years (through April 1990), usage was even lighter, with only two credits for cereal imports (to Algeria and Mexico, both in June 1989, in conjunction with the approval of a stand-by and an extended arrangement, respectively). Nonetheless, although the cereals window benefited few countries in the 1980s, it provided significant and timely assistance for those countries at times when they were hardest hit by external conditions beyond their control. For that reason, the Fund kept it in place through the many changes in the facility that took place in the late 1980s and the 1990s.[69]

Tightening the Conditions, 1983

The two years after the establishment of the cereals window were a golden age for the CFF: 47 countries borrowed a total of SDR 5.4 billion ($6 billion) through the facility in fiscal years 1982–83 (see Figure 15.2). In most cases, those countries also had stand-by or extended arrangements in effect simultaneously. Nonetheless, the question of what "cooperation" meant would not go away. If a country did not have a Fund-supported adjustment program in place, how was the Fund to judge whether the country's policies were appropriate? A continuing trickle of cases kept flowing in, in which countries could not (or would not) put together an acceptable program but otherwise qualified for compensatory financing.[70] In practice, such cases were handled by keeping the country's CFF obligations within the lower 50 percent limit, but the Board was becoming increasingly disenchanted with its own longstanding preference for ambiguity in CFF conditionality. In 1983, the staff responded to those concerns by proposing specific standards for the lower and upper tranches. Those standards were approved by the Executive Board in September, with little change.

The new standard for the lower tranche (up to 50 percent of quota in total CFF obligations) was that the country had to be willing to receive Fund missions and

[68]"Review of the Decision on Compensatory Financing of Fluctuations in the Cost of Cereal Imports," SM/87/86 (April 8, 1987), pp. 5–9.

[69]The cereals window initially was established for a fixed term of four years. It was extended without modification in 1985, 1990, and 1994.

[70]For countries facing both a general balance of payments problem and a qualifying "temporary shortfall," the low-conditionality CFF offered an unambiguous advantage over a stand-by arrangement. In 1981, the staff suggested counteracting that advantage by setting the interest rate charged on CFF credits at the prevailing market rate, rather than at the lower rate of charge on stand-by and other credit-tranche drawings. That proposal was supported by a majority of the votes in the Executive Board, but such a change required a 70 percent majority. Directors from developing countries, with a little over 40 percent of the vote, were thus were able to block it from taking effect. Minutes of EBM/81/37–38 (March 9, 1981). The outcome of the debate is summarized at meeting 81/38, p. 26.

discuss its balance of payments problem and possible solutions. If the Fund determined that the country's policies were "seriously deficient" or that its "record of cooperation in the recent past has been unsatisfactory," then the Fund would expect the member to begin a program of corrective action before approval of the request. Those conditions were similar to the requirements for a stand-by arrangement in the first credit tranche. For credits that would take the country's indebtedness into the upper tranche (up to 125 percent of quota), the additional requirement was specified that the country should have a satisfactory balance of payments situation (apart from the calculated temporary export shortfall or excess import costs), or a Fund-supported adjustment program in effect, or a program in effect that would qualify for Fund support "in the credit tranches" if requested.[71] These conditions were similar to those for an upper credit tranche stand-by arrangement, although the quoted phrase deliberately left the door open for situations that would have qualified only for support in the first credit tranche.

On paper, these conditions merely made specific what had long been implicit in the Fund's evaluation of requests for CFF credits. In practice, they would raise the hurdle for countries without stand-by arrangements to qualify for CFF support. During the Board discussion, several speakers (including the Managing Director) maintained that the proposed standard was merely an interpretation, while others worried aloud that the facility was being fundamentally changed. Jacques Polak argued that "compensatory financing should be available promptly" and without "special conditions." It was he who asked that conditionality be imposed in the lower CFF tranche only if policies were "seriously deficient" and not just "deficient." Julius Ismael (Indonesia) garnered the support of several of his colleagues in arguing that "the guidelines constituted a tightening of conditionality that was inconsistent with the objectives of compensatory financing." R.N. Malhotra (India) tried to delay consideration of the proposals on the grounds that they would "change the nature" of the CFF, but the Managing Director assured him and others that "it was not the intention of the staff to formulate a new policy" and that "the proposed guidelines represented the Fund's practice." On that understanding, the proposal was approved, but by a deeply divided Executive Board.[72]

After the new conditionality guidelines were approved, borrowing from the CFF dropped off sharply. More significantly, almost all CFF credits were now made in conjunction with stand-by or extended arrangements.[73] As Polak later observed (in

[71]Executive Board Decision No. 7528-(83/140), adopted September 14, 1983; *Annual Report 1984*, p. 137. For the original staff proposal, see "Requirement of Cooperation Under the Compensatory Financial Facility," EBS/83/171 (August 12, 1983).

[72]Minutes of EBM/83/130 (September 6, 1983), p. 17 (Polak); EBM/83/131 (same date), p. 3 (Malhotra) and p. 12 (de Larosière); and EBM/83/140 (September 14, 1983), p. 47 (Ismael) and p. 53 (de Larosière).

[73]From September 1983, when the new guidelines took effect, to the end of 1986, 27 out of 33 credits through the CFF—and all but 1 of the 27 credits in the CFF "upper tranche"—were made in conjunction with a new stand-by or extended arrangement or were to countries with existing arrangements. "Compensatory Financing Facility—Recent Experience and Issues for Consideration," EBS/87/13 (January 26, 1987), pp. 8–9.

the 1991 essay cited above), since the staff considered all sources of finance in determining the appropriate size of a stand-by arrangement, it is reasonable to conclude that auxiliary CFF credits did not provide truly additional resources to the borrower. The borrower got more money up-front, but the later installments of the stand-by arrangement were likely to be smaller as a result. The underlying rationale for this effective downgrading of the facility was that it was rare in practice (at least in the 1980s) for a country to have a temporary and exogenous export shortfall without also having a more persistent balance of payments problem requiring a substantial policy correction. The option of covering a purely compensatory case was never abolished (having a stand-by arrangement was a sufficient, not a necessary, condition for meeting the "cooperation" test), but that option became largely irrelevant.

Tighter conditionality was not the only explanation for the reduced usage of the CFF. Three other reasons were important in the second half of the 1980s.[74] First, the markets for many primary commodities became *permanently* rather than temporarily depressed.[75] The massive and generalized decline in commodity prices in those years was unprecedented in modern history (see Boughton, 1991). Though it seems ironic that the more sustained the decline, the less likely are exporters to qualify for compensation, the effect was to shift the focus to the need for longer-term financial support and for deeper adjustments in economic policies. Second, countries that succeeded in diversifying their economies away from dependence on one or a few primary commodities effectively graduated from the CFF. Although the number of successful cases may have been small, diversification does seem to have had a positive overall effect. Third, many of the countries that are most vul-

[74]An additional restrictive factor was introduced more gradually and without a formal decision. Starting in 1983, the Fund occasionally approved stand-by or extended arrangements "in principle," pending completion of financing commitments by other creditors (see Chapter 9). Since Articles I and V of the Fund's Articles of Agreement require the Fund to establish "adequate safeguards" on the use of its resources, the staff considered it appropriate to consider delaying CFF drawings when the Executive Board approved an associated arrangement "in principle." Whether CFF drawings were delayed was determined on a case-by-case basis. (See the discussion in Chapter 10 (pp. 467–71) of a CFF credit for Argentina that was allowed in February 1987 even though the associated stand-by arrangement was approved only in principle, and the discussion in Chapter 13 (pp. 578–85) of a credit for Côte d'Ivoire that was delayed in December 1987 along with the stand-by arrangement.) In such cases, Executive Directors occasionally objected on the grounds that delaying the CFF drawing violated the spirit of the facility. In 1988, however, the Executive Board agreed that the Fund's policy on financing assurances should apply to the CFF as well as to stand-by arrangements. See minutes of EBM/88/16–17 (February 5, 1988).

[75]The impact of this factor was limited, or at least delayed, by the inevitability of forecast errors. Because the calculation of a temporary shortfall required forecasting commodity prices for two years ahead, credits often were extended on a false expectation that a current shortfall would be temporary. A 1987 internal study found that forecast errors from 1976 through 1985 had been frequent and large but not biased. Even so, because many countries with underestimated shortfalls had been constrained by the CFF lending limits, the resulting pattern of credits was biased toward overcompensation. For 1976 through 1985, countries were compensated with SDR 10.8 billion in CFF credits for an estimated SDR 19.3 billion in temporary export shortfalls. With perfect foresight, temporary shortfalls were slightly larger (SDR 19.8 billion), but the Fund would have extended just SDR 7.4 billion in credits. "Review of the Compensatory Financing Facility—Annexes," EBS/87/165, Sup. 1 (July 30, 1987), p. 47.

nerable to the vagaries of world markets for primary commodities also have very low per capita incomes. The establishment of the SAF in 1986, and the ESAF in 1987, provided a much less costly and more appropriate vehicle for providing loans to those countries.

A special case arose when oil prices declined sharply in 1981–82 and again in 1985–86, quite apart from the problem of assessing at the time whether the decline was likely to be temporary or permanent. Because international trade in oil was so large (it accounted for about half of all world trade in primary commodities), potential borrowing to compensate for price declines could have added greatly to total demands on the CFF and could even have put pressure on the Fund's overall liquidity position.[76] Even if the declines had been recognized as permanent, they were large enough that they would have justified large borrowings by exporters.[77] The CFF, however, required that a temporary shortfall in export revenues be beyond the control of the authorities. Since most major oil exporters belonged to the Organization of Petroleum Exporting Countries (OPEC), a central question was whether OPEC determined oil prices or merely set prices in accordance with market conditions.

In May 1983, the Fund staff concluded that there were "doubts as to whether OPEC actions have been consistently determining in respect of export earnings" for its members, and it recommended that requests be considered and evaluated on a case-by-case basis. That conclusion did not dispel the uneasiness felt by a number of Executive Directors, which was perhaps expressed best by Guenter Grosche (Alternate—Germany): ". . . if in certain periods a particular country had cooperated with others to establish a price level that turned out not to be sustainable, it could be considered as having created shortfalls." The Board agreed unanimously that OPEC membership per se was irrelevant, but it reiterated that a country's "output, stockpiling, and price policies" were relevant for deciding whether a shortfall was beyond the authorities' control.[78]

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[76]Throughout the CFF liberalization phase of 1975–79, calculations of potential use had been made on the assumption that neither industrial countries nor oil exporters would avail themselves of the facility. As discussed in Chapter 7, concerns about opening the floodgates led management to persuade Mexico to drop plans to borrow through the CFF for an oil export shortfall in 1982.

[77]To take a simple numerical example, suppose that a country earns $100 from exports for two years and that exports then drop to $50 for the next three years. The five-year annual average is $70 (or $66, using geometric averaging), and the $20 (or $16) difference between that average and exports in year three counts as a "temporary shortfall." In March 1986, following a major decline in oil prices, the staff calculated that all of the 26 oil-exporting developing countries could qualify for maximum CFF access in the course of the year, based on calculated temporary shortfalls in oil exports, and it estimated that actual requests might come from seven or so countries and total between SDR 2 and 2½ billion through mid-1987. "CFF—Fuel Exporting Countries," memorandum from William C. Hood (Economic Counselor and Director of Research) to the Managing Director (March 27, 1986); IMF/CF (S 1181 "Compensatory Financing of Export Fluctuations, January 1986–March 1987").

[78]The staff conclusion is in "Compensatory Financing Facility—Requests for Drawings by Oil Exporters," SM/83/87 (May 16, 1983), p. 16. For the Executive Board's conclusions, see the Chairman's summing up, minutes of EBM/83/80 (June 2, 1980), pp. 23–25. Grosche's statement was made at EBM/83/79 (same date), p. 22.

In the event, only two requests for CFF drawings related to oil exports were submitted in the 1980s. In August 1986, Ecuador borrowed SDR 39.7 million ($48 million; 26 percent of quota) to compensate for a shortfall in oil export earnings, as an adjunct to a stand-by arrangement approved at the same time. Relevant factors were that Ecuador had consistently produced oil at capacity rates rather than at levels determined by OPEC quotas, and that it was a small enough producer to be regarded as a price taker in international markets.[79] In May 1987, Indonesia borrowed SDR 462.9 million ($602 million; 46 percent of quota) for a shortfall in oil and other exports. Since Indonesia had a good record of cooperation with the Fund and was making only a small drawing that could have been justified without reference to the oil shortfall, that request also was viewed favorably.[80]

Covering Contingencies, 1988

Although the Executive Board generally rejected proposals to include automatic contingency clauses in stand-by arrangements (as discussed in Chapter 13), the broader idea of covering contingencies had an undeniable appeal. In March 1987, the Board considered a proposal for establishing a new window within the CFF to compensate indebted countries in the event of unanticipated increases in interest rates, but that idea also was rejected as inconsistent with the purposes of the facility. What then became clear was that for a contingency mechanism to succeed in generating broad support, it would have to be comprehensive in coverage and symmetric in application. That is, it should relate to the broad determinants of export revenues and should also trigger reductions in the Fund's commitments if developments turned out more favorably than expected. That notion was encapsulated in a June 1987 report by the Deputies of the Group of Twenty-Four developing countries (G-24).[81]

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[79]Minutes of EBM/86/136 (August 15, 1986).

[80]Ecuador and Indonesia also borrowed through the CFF in 1983, but those drawings were linked to shortfalls in non-oil exports. Indonesia's export shortfall in 1987 was attributable to a wide range of products, but about 70 percent of the total was due to oil (plus 17 percent for liquefied natural gas). The requested CFF drawing, however, was smaller than the calculated shortfall for non-oil exports; that fact was cited by the Executive Directors for the United States, Germany, Italy, and Canada as relevant to their approval of the request. In 1989, the Venezuelan authorities expressed interest in an oil-related CFF drawing, but they did not submit a formal request.

The background to the 1987 credit to Indonesia is given in "Indonesia—Use of Fund Resources—Compensatory Financing Facility," EBS/87/77 (April 13, 1987). For the Board discussion, see the minutes of EBM/87/67 (May 4, 1987). The 1983 shortfall is described in "Indonesia—Use of Fund Resources—Compensatory Financing Facility," EBS/83/145 (July 12, 1983).

[81]Intergovernmental Group of Twenty-Four (1987), paras. 67–71. The specific proposal was that a Letter of Intent for a Fund-supported adjustment program would include projections for key exogenous variables. The stand-by arrangement would include a formula under which the amount of Fund resources available would be increased or decreased by specified amounts if conditions turned out to be less or more favorable. The report was circulated in the Fund as "Report of the Deputies of the Group of Twenty-Four on the Role of the Fund in Adjustment with Growth," EBD/87/196 (July 22, 1987).

In July 1987, the staff responded to the G-24 request by developing a detailed proposal for a contingency mechanism that would operate alongside the CFF but would be activated by deviations from assumptions made at the time that a stand-by arrangement was approved. The member and the Fund would agree at the outset on projections for export revenues during the life of the arrangement. If a shortfall occurred, the Fund could compensate by extending additional financing; if events turned out favorably, the Fund could reduce its commitment under the stand-by arrangement. Two months later, at the Annual Meetings, U.S. Treasury Secretary James A. Baker III, took that idea a step further and proposed replacing the CFF with a new "external contingency facility" designed to "help cushion the adverse effects on stand-by programs of external, unforeseen developments such as weaker commodity prices, lower export volumes, natural disasters, and sustained higher interest rates."[82] Now the idea had momentum for both creditors and indebted countries, and the only question was what form it might have. In the view of the developing countries, the goal was to devise a means of providing additional support for countries facing adverse circumstances. In the U.S. view, the goal was to replace the low-conditionality CFF with a new facility that would provide a similar level of financing but would be linked more firmly to conditional stand-by arrangements.

The next several months were devoted to finding a workable compromise. Although this effort technically succeeded, it produced a hydra-headed facility of mind-numbing and self-defeating complexity.

The proposal to scrap the compensatory facility with one designed only to handle contingencies for program countries was quickly rejected by the Executive Board in November 1987. Even though the existing facility had fallen into disuse, a large majority of Directors considered that it still had a "vital" role to play in the event of future export shortfalls. Accordingly, Jacques de Groote (Belgium) proposed "enhancing" the existing CFF by adding a window for compensating countries in case of adverse external shocks.[83] That general idea quickly gained popularity as a possible compromise, and the choice effectively was narrowed to the de Groote proposal (an option that became known as an "external contingency mechanism," or ECM) and the more general G-24 notion of adapting stand-by arrangements to deal with contingencies (an "internal contingency mechanism," or ICM).

In an extraordinarily drawn-out series of 11 meetings in March 1988, the Executive Board agreed that the CFF could be expanded to include a contingency window, but Directors expressed a wide range of views on the implications for the standard compensatory windows. Dallara was pushing to cut access for export shortfalls from a maximum of 83 percent (see footnote 65, p. 732) to 25 percent, while most

[82]IMF, *Summary Proceedings*, 1987, pp. 110–11. The U.S. Executive Director, Charles H. Dallara, who initiated the idea in the U.S. Treasury, circulated an elaboration of the proposal to his colleagues on the Executive Board shortly after the Annual Meetings. Dallara's statement on "U.S. proposals for Strengthening the Fund's Role in the Debt Strategy" was circulated informally on October 9; an expanded version was presented at EBM/87/156 (November 17, 1987), pp. 17–23.

[83]Chairman's summing up, minutes of EBM/87/157 (November 18, 1987), p. 10, and EBM/87/158 (same date), pp. 65–68. For de Groote's proposal, see EBM/87/157, pp. 68–72.

others insisted on retaining at least 50 percent for that purpose. By the end of March, however, Dallara agreed to consider a 40 percent ceiling for export shortfalls, and that move went a long way toward securing an agreement.[84]

The core of the compromise that the Managing Director submitted to the Interim Committee for its April 1988 meeting was that the "essential features" of compensatory financing would be preserved, while access would be further restricted. If a country had an otherwise satisfactory balance of payments and had the capacity to service additional debt, it could still get a CFF credit equivalent to 83 percent of its quota. As before, it could also get a credit for excess cereal imports, subject to an overall ceiling of 105 percent, although the ceiling on access for cereal imports alone was left open for the time being.[85]

In the much more common case where a temporary and exogenous export shortfall came on top of other difficulties, the country could get a credit for 40 percent of its quota if it "was willing to cooperate with the Fund in an effort to find an appropriate solution to its balance of payments problems." If the country had an "unsatisfactory" record of cooperation in the past or if its "existing policies were seriously deficient," the Fund could require "prior actions" before approving the credit and could delay a "second tranche" (half of the 40 percent available) until an approved adjustment program was in place. A country also could apply for an "optional tranche" of up to 25 percent of quota (for a total of 65 percent), if it had an adjustment program in place (either supported by Fund financing or strong enough to qualify); for countries subject to the "prior actions" guideline, the optional tranche would not be made available until the Fund's first review of the program. (These guidelines on the meaning of cooperation were intended to clarify rather than alter existing practices.) In addition, the Board agreed that countries could obtain up to 40 percent of quota under the new contingency mechanism, and up to 25 percent under the "optional tranche" as an alternative to using that 25 percent under the compensatory window. Thus the intention was that total potential access under the new arrangements would remain at 105 percent, but it would be allocated in new and more complex ways.

With the blessing of the Interim Committee,[86] the Board next turned to the difficult task of agreeing on specific operational features (or "modalities," in the preferred jargon of the Fund) of the contingency window. Several of these features were largely technical and need not be reviewed here.[87] Moreover, one central

[84]Minutes of EBM/88/30–31 (March 4, 1988), EBM/88/37–38 (March 11, 1988), EBM/88/50–51 (March 28, 1988), and IS/88/1–5 (March 31 through April 7, 1988). Dallara's compromise proposal is on p. 20 of EBM/88/50.

[85]See "Compensatory Financing Facility and External Contingency Mechanisms," ICMS/Doc/88 (April 8, 1988).

[86]See para. 7 of the Interim Committee communiqué (April 15, 1988), in *Annual Report 1988*, p. 148.

[87]For example, decisions were required on issues such as how to phase contingent drawings, especially in multiyear arrangements; how to link drawings with stand-by arrangements that had been approved only in principle; and how to make transitional provisions for countries that had outstanding obligations in excess of the new limits.

question—what contingencies to cover—had already been decided in the preliminary discussions: export earnings, import prices (but not quantities), and the effects of changes in "international benchmark" interest rates. Other components of the current account, notably workers' remittances and tourism earnings, could be covered if they were particularly important for a country.[88] The idea was that a Fund-supported adjustment program[89] would specify assumed values for these variables. If circumstances deteriorated, the Fund would provide additional credits; if circumstances turned out to be better than expected, the amounts available might be reduced, the authorities might be expected to repay credits early, or they might be required to increase the target level of international reserves.

Much debate ensued throughout June and July 1988, on how to delineate the Fund's involvement and how to integrate this contingency mechanism into the existing CFF and create what was now being awkwardly called the Compensatory and Contingency Financing Facility (CCFF).[90] Despite the intricacy of arguments about access limits, thresholds, discount factors, double compensation, etc., the essence of the debate was over how much of the "essential features" of compensatory financing should be retained, and how much (if at all) the Fund's overall potential financial commitment should be expanded.

Advocates of an expanded facility were prepared to accept lower lending limits under the old compensatory windows in exchange for a new contingency mechanism, but they pushed hard for an overall increase in the size of the facility. Adding a contingency window with a ceiling of 40 percent of quota into a facility with a total limit of 105 percent implied reducing access under the export or cereal windows from 83 to 65 percent. Keeping the original ratio of joint access (exports and cereals combined) to access for each window implied setting a joint limit of 82 percent (82/65 = 105/83). That simple mathematics eventually persuaded the Board to agree to raise the overall limit from 105 to 122 percent (82 + 40). Although it was extremely unlikely that any country would ever face such a multiplicity of problems that it could draw anywhere near that limit, at least the theoretical maximum would be higher than before.[91] Within that limit, a country could borrow 40 percent of quota each for export shortfalls and contingencies and 17 percent for excess cereal imports. Any one window could be augmented by up to 25 percent

[88]In the event of multiple deviations, the basis for contingency financing was to be the net sum. To qualify, the net deviation had to exceed a specified threshold, which normally was to be 10 percent of the country's quota. The covered amount then was to be reduced uniformly by 4 percent of quota. The associated stand-by arrangement was to specify the portion of the deviation to be covered by additional Fund financing (which could be up to 100 percent).

[89]Programs supported by SAF or ESAF loans also qualified, in addition to those supported by stand-by or extended arrangements.

[90]The name was introduced in "Modalities for the Compensatory and Contingency Financing Facility," EBS/88/100 (May 24, 1988). Until then, the proposal was described even more awkwardly as the "CFF/ECM facility."

[91]A further limiting factor was that contingency financing could not exceed 70 percent of the total amount available under the associated arrangement. As before, drawings under the new facility "floated"; that is, they did not count against the borrower's reserve tranche balance or the overall limits on annual or cumulative access to Fund resources.

of quota (the "optional tranche"). Thus the cereals window was subjected to a much larger reduction than the export window, but since it never had been of much use, its downgrading was little lamented.

Another complication concerned the treatment of unanticipated increases in interest rates. That element of the contingency mechanism was potentially of great value to highly indebted countries, but it worried some creditor countries and raised serious questions about the economic effects of the mechanism. If international interest rates rose, and the Fund responded by providing additional financing to an indebted country, the extra resources might principally benefit other creditors rather than the borrower. To circumscribe this problem, the Board agreed to limit financing for interest rate deviations to no more than 35 percent of quota. It also decided that the Fund should seek to get agreements from other creditors to increase their own exposure in such cases.[92]

The Executive Board reached agreement on all particulars at the beginning of August 1988, and it formally adopted the decision creating the CCFF on August 23. Once the facility became operational, however, demand for it turned out to be quite limited, and almost no money became available to borrowers through the contingency window. During the first 12 months of CCFF operations, the Fund negotiated and approved 29 arrangements,[93] only 12 of which included contingency provisions. In one case, an extended arrangement for the Philippines, the covered variables stayed within bounds, and the contingency provisions were not activated. In the other, a stand-by arrangement for Trinidad and Tobago, an unanticipated increase in oil export revenues triggered the symmetry provisions and resulted in an increase in the target for net international reserves.[94]

Why were borrowing countries so reluctant to request contingency provisions in adjustment programs? At least four reasons seem to have been important in several instances.[95] Certainly the symmetry provisions were a major deterrent. Borrowing countries could always try to deal with adverse developments by requesting modifications or waivers after the fact, and that strategy evaded the symmetry provisions. Second, in some cases the access limits were so small relative to the size of

[92]After several years of frustrating experience with concerted lending agreements, no one wanted to make the contingency mechanism inflexibly dependent on cooperation from commercial banks. Consequently, the Decision creating the new facility included only a requirement that the program be "adequately financed, including, if necessary, through the provision of financing from other sources" (para. 24). For the full Decision, see *Annual Report 1989*, pp. 84–89. The Chairman's summing up of the Board discussion on July 6, which provided detailed background on operational features, noted that "parallel contingent financing from commercial banks will be pursued vigorously" but would be required only in cases where "necessary to ensure adequate financing of the program." See minutes of IS/88/8 (July 6, 1988).

[93]This total excludes nine arrangements for which negotiations were essentially complete before the CCFF became operational.

[94]"Trinidad and Tobago—Stand-by Arrangement—Review and Request for Modification of Performance Criteria," EBS/89/135, Sup. 1 (July 13, 1989). The first drawing under the contingency provisions of the CCFF was made by Bulgaria in 1992.

[95]Also see Polak (1991), pp. 11–12, for a discussion of the strengths and weaknesses of the contingency mechanism.

potential shocks that the authorities did not think it worthwhile to negotiate the detailed baseline scenarios and other terms required for contingency clauses. Third, the requirement to seek "parallel financing" from other creditors constituted a potential obstacle and created uncertainties about the value of the Fund's contingent commitments. Fourth, many countries were put off by the CCFF requirement for "broad coverage" in calculating contingencies, which often necessitated detailed and complex calculations. Four programs approved in 1988–89 (extended arrangements for Chile, Mexico, and Venezuela, and a stand-by arrangement for Nigeria) included more narrowly targeted contingency clauses outside the framework of the CCFF.[96] Ironically, the Fund's laborious negotiations to establish the CCFF succeeded to some degree in stimulating interest in contingent financing, but that demand was satisfied primarily through existing channels rather than through the new facility itself.

Other Lending Arrangements

Buffer Stock Financing Facility

Economies that are dependent on selling primary commodities suffer from two interrelated problems: a secular downward trend and high cyclical volatility in world market prices (both measured relative to prices of manufactured goods). Because the trend is difficult to measure and is unlikely to remain constant over time, producers can never know just where they stand in relation to the cycle.[97] Despite the odds, at times of high volatility—beginning in the 1930s but especially in the 1970s and early 1980s—developing countries have tried to form alliances aimed at stabilizing commodity prices near trend levels. Oil exporters formed by far the largest and most visible coalition (OPEC),[98] while less well known groups aimed to stabilize prices of commodities such as cocoa, coffee, rubber, sugar, tea, and tin.[99] In 1969, the IMF established the Buffer Stock Financing Facility (BSFF) to support the stabilization activities of certain of these agreements.

[96]The Chilean provisions related to the price of copper, and the other three all were linked to the price of oil exports.

[97]For a discussion of the difficulties in assessing the trend in relative commodity prices, see Boughton (1991).

[98]Although OPEC's initial goal was to raise prices to what participants judged to be equilibrium levels, later activities were aimed at stabilizing output and prices. Its members did not maintain buffer stocks, and it was never considered for inclusion in the BSFF.

[99]During the 1970s, various efforts were made within the United Nations to generalize the goals of the buffer stock agreements that were being established for specific commodities. The Integrated Programme for Commodities was established by UNCTAD in May 1976 to coordinate and promote international commodity agreements. Agreement within UNCTAD to establish the Common Fund for Commodities was reached in June 1980. The intent of the Common Fund was to stabilize commodity prices by providing financial assistance to international commodity organizations. For a summary of developments through mid-1980, see "Recent Developments in Programs of Export Earnings Stabilization," SM/80/182, Rev. 1 (August 5, 1980).

The essence of the BSFF was that the Fund would lend to member countries that were required under specified international agreements to purchase buffer stocks of their exportable commodities at times when prices would otherwise be cyclically depressed. To qualify for such a credit, a country would have to be a participant in a scheme approved by the Fund, and it would have to represent to the Fund that it faced a balance of payments need associated with its financing requirement and would cooperate with the Fund in finding a solution to the problem. A central criterion for an international agreement to qualify was that it had to be directed toward stabilizing the price of a commodity around a medium-term trend. Terms and access limits on credits through the BSFF were broadly similar to those for the CFF, and the pair of facilities were intended to provide two-pronged assistance to developing countries. The buffer stock facility would provide up-front financing to help countries stabilize export prices, and the compensatory facility would provide backup support if export earnings temporarily dropped anyway.[100]

Buffer stock lending began in 1971, some two years after the facility was established. From then through the end of the 1980s, the Fund lent a total of SDR 558 million ($612 million) to 18 countries. In value terms, most of that lending took place in 1982 and 1983; no new lending occurred after the spring of 1984, and by the end of 1988 all BSFF credits had been repaid (Figure 15.3).

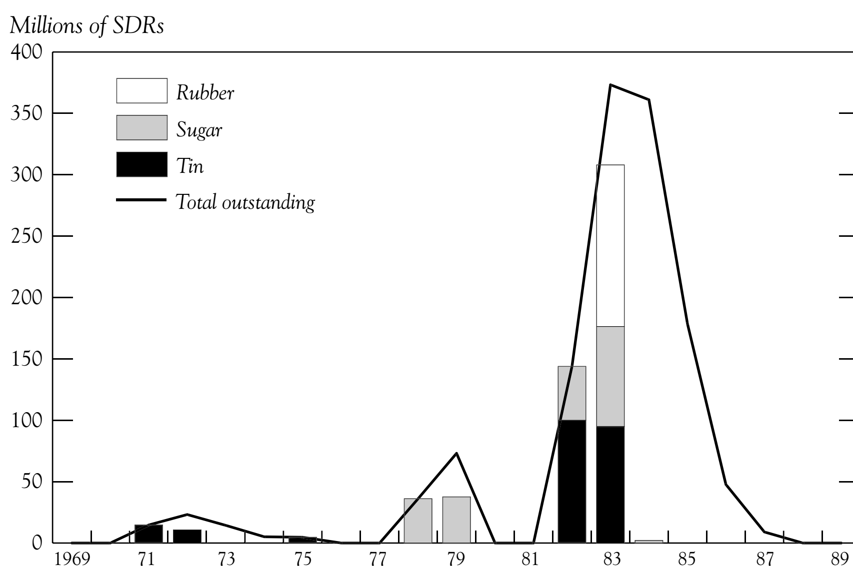
Lending for this purpose was highly episodic. All of the credits through 1975 went to five countries participating in the Fourth International Tin Agreement (Bolivia, Indonesia, Malaysia, Nigeria, and Thailand). In the second short burst of activity, the Fund provided credits to six countries (Australia, the Dominican Republic, Guyana, Jamaica, Nicaragua, and the Philippines) to finance their participation in the 1977 International Sugar Agreement. The heyday of the facility then came in 1982–84, when the Fund lent SDR 453 million ($483 million) to 13 countries participating in the tin and sugar agreements and the 1979 International Natural Rubber Agreement.[101] At its peak at the end of 1983, the BSFF accounted for 1.2 percent of total Fund credit and loans outstanding.

The sugar agreement expired at the end of 1984 after producers failed to find an acceptable means of coping with a large increase in world supply engendered by the price support programs of the European Communities and the United States. The tin agreement—the last in a series of international efforts to fix a world price for tin, dating from 1956—was abandoned in 1985 when its managers finally real-

[100]For the origins of the BSFF, see de Vries (1976), Vol. 1, pp. 269–86. Developments in the 1970s are covered in de Vries (1985), pp. 417–21. The CFF covered the full value of a country's export earnings, not just those derived from specific commodities.

[101]The 1972 International Cocoa Agreement also was approved by the Fund as a qualifying scheme, but no credits were extended for that purpose, and the agreement lapsed in March 1980. During 1982–84, Indonesia, Malaysia, and Thailand borrowed for both rubber and tin stocks; Côte d'Ivoire and Sri Lanka borrowed for rubber stocks; Australia, Brazil, the Dominican Republic, Malawi, Mauritius, Swaziland, and Zimbabwe borrowed for sugar stocks; and Bolivia borrowed for tin stocks.

Figure 15.3. Buffer Stock Financing, 1969–89



ized that its goals were far out of line with market conditions.[102] After that, only one eligible agreement—rubber—survived. The BSFF remained ready to provide credits if requested, but, at least for the time being, it was not needed.

Emergency Disaster Relief

In January 1962, the Fund agreed to lend Egypt $22.4 million (25 percent of quota) against collateral of an equivalent amount in gold. Although the drawing pushed Egypt's obligations into the third credit tranche, the Fund did not require the authorities to submit an adjustment program. That exception was formally based on the provision of collateral, but the Executive Board also noted that the request was motivated by a dire economic emergency. Much of Egypt's rice crop had been wiped out by flooding in the Nile valley in 1961, and now the cotton crop had been devastated by an infestation of cotton leaf worms. To insist that the usual conditionality be negotiated before approval of the credit would force a deprivation on the country that most Directors felt was unnecessary. (See Horsefield, 1969, Vol. 1, pp. 524–25.) The Fund thus embarked on the practice of occasionally granting emergency relief to countries facing natural disasters.[103]

For 17 years following the assistance to Egypt, the Fund provided emergency relief for natural disasters in just four instances (Table 15.1): following earth-

[102]On the sugar agreement, see "Buffer Stock Financing Facility—Report on the 1977 International Sugar Agreement," SM/84/232 (October 19, 1984). On tin, see "Buffer Stock Financing Facility—International Tin Agreement," SM/86/271 (November 5, 1986).

[103]The World Bank also provided emergency loans for disaster relief; see Kapur and others (1997), pp. 341–42.

Table 15.1. Emergency Disaster Relief, 1962–89

Country	Date	Nature of Disaster	Amount (Millions of SDRs)	Amount (Millions of dollars)[a]	Amount (Percent of quota)
Egypt	January 1962	pest infestation		22.4	25
Yugoslavia	September 1963	earthquake		30.0	25
India	April 1966	drought		187.5	25
Nicaragua	May 1973	earthquake	12.0	14.3	44
Chad	May 1974	drought	2.8	3.4	22
Dominican Republic	September 1979	hurricane	23.3	30.4	42[b]
Dominica	December 1979	hurricane	1.0	1.3	50[c]
St. Lucia	November 1980	hurricane	1.8	2.3	50[d]
St. Vincent and the Grenadines	November 1980	hurricane	0.4	0.5	25[e]
Yemen, P.D.R.	July 1982	floods	15.4	16.8	25[f]
Yemen Arab Republic	March 1983	earthquake	9.8	10.6	50
Mexico	January 1986	earthquake	291.4	320.0	25
Madagascar	May 1986	cyclone	16.6	19.4	25[g]
Solomon Islands	September 1986	cyclone	1.3	1.6	25
Ecuador	June 1987	earthquake	37.7	48.5	25
Bangladesh	November 1988	floods	71.9	97.6	25
Jamaica	February 1989	hurricane	36.4	47.9	25

[a]The Fund's accounts have been expressed in SDRs since 1972. Amounts in U.S. dollars shown after that date are converted at prevailing exchange rates.

[b]Plus 50 percent of quota, as a CFF drawing for export shortfalls.

[c]Plus 69 percent of quota, as drawings on the reserve tranche (19 percent) and through the CFF (export shortfalls, 50 percent).

[d]Plus (in March 1981) a CFF drawing equivalent to 50 percent of the enlarged quota (75 percent of the 1980 quota) for export shortfalls related to the hurricane.

[e]Plus 19 percent of quota, as a drawing on the balance of the reserve tranche; and (in March 1981) 50 percent of the enlarged quota (76 percent of the 1980 quota) through the CFF, for export shortfalls related to the hurricane.

[f]Plus 4 percent of quota, as a drawing on the balance of the reserve tranche.

[g]Plus 24 percent of quota, as a CFF drawing for export shortfalls.

quakes in Yugoslavia in 1963 and Nicaragua in 1973, and in response to droughts in India in 1966 and Chad in 1974. Credits ranged from 22 to 44 percent of the borrower's quota. Beginning in 1979, both the frequency and the average size of emergency assistance picked up temporarily. Specifically, in 1979 and again in 1980, the Caribbean region was affected severely by hurricanes. Following Hurricane David, which hit at the end of August 1979, both the Dominican Republic and Dominica obtained emergency assistance from the Fund, amounting directly to 42 and 50 percent of quota, respectively.[104] If associated drawings on the re-

[104]Assistance to the Dominican Republic was approved in record time (about two weeks), owing to special circumstances. In July 1979, the authorities requested a drawing through the CFF for export shortfalls, plus a stand-by arrangement for the first credit tranche. A staff mission went to Santo Domingo in August and was concluding negotiations when news came of the approaching storm. The staff managed to leave just ahead of the hurricane. The authorities then requested a drawing for emergency assistance as a substitute for the stand-by arrangement, which the Executive Board approved in September along with the CFF drawing. See minutes of EBM/79/158 (September 17, 1979).

serve tranche and through the CFF are taken into account, financial assistance to those two countries averaged a little over 100 percent of quota (see the notes to Table 15.1). A year later, similar assistance was provided to St. Lucia and to St. Vincent and the Grenadines, to help them cope with the damage from Hurricane Allen.

On several occasions in 1980, during discussions on the proposed "food facility" (which became the cereals window of the CFF), the Executive Director for three of the four hurricane-damaged economies—Bernard J. Drabble (Canada)[105]—proposed that the Fund "formalize" its procedures for granting emergency assistance by establishing a "disaster facility, or disaster tranche" on the understanding that drawings would have to be either repaid quickly or followed by a stand-by arrangement.[106] Neither the staff nor management was particularly eager to attempt to specify conditions for such assistance in advance, and they delayed responding as long as they could. When they finally did submit a paper to the Board, for discussion in February 1982, they urged against creating a new facility and proposed essentially that existing procedures be retained.[107]

The Executive Board agreed with the staff that a formal facility was not needed, and it accepted the idea that emergency assistance should be subjected to a minimal degree of conditionality, essentially equivalent to what was required of countries seeking to draw on their first credit tranche. That is, the authorities would have to submit a statement indicating their willingness to cooperate with the Fund in finding a lasting solution to their balance of payments problems and their intention to implement appropriate policies. By a narrow majority, the Board also agreed that emergency assistance would normally be limited to one credit tranche (25 percent of quota), apart from other non- or low-conditionality drawings that might be available (notably reserve tranche or CFF drawings). On that question, 9 of the Fund's 22 Executive Directors, all of whom spoke for developing countries and who collectively held about 30 percent of the votes on the Board, argued for a larger limit.[108] Others, however, expressed concerns that in most emergency cases up to that time, the borrowing country had not carried out the intentions expressed in its supporting statements; prudence therefore dictated that amounts disbursed quickly should be kept small.[109]

Following adoption of these guidelines, the Fund granted emergency assistance about once a year for the rest of the 1980s, almost always for 25 percent of

[105]The Dominican Republic, an original member of the Fund, was in the constituency of Alexandre Kafka (Brazil). Dominica, St. Lucia, and St. Vincent all became members of the Fund after the 1978 election of Executive Directors and were formally in Drabble's constituency only as of November 1980.

[106]See statements by Drabble at EBM/80/119 (August 4, 1980), p. 11 ("formalize"); EBM/80/130 (September 4, 1980), p. 8, where he raises the link with an adjustment program; and EBM/80/179 (December 10, 1980), p. 6 ("disaster facility").

[107]The guidelines adopted by the Executive Board on February 10, 1982, are reproduced in Appendix II to this chapter.

[108]Two of the nine included industrial as well as developing countries in their constituencies: Michael Casey (Alternate—Ireland) and Miguel A. Senior (Alternate—Venezuela).

[109]Minutes of EBM/82/15–16 (February 10, 1982).

quota.[110] In each case, the credits were approved within 2½ to 5 months of the natural disaster. In the majority of cases, the borrowing countries already had a stand-by arrangement in place or were negotiating one, so the question of additional conditionality did not arise. That circumstance applied to the drawing that was by far the largest, by Mexico in January 1986, following the earthquakes of September 1985. As discussed in Chapter 10, Mexico was involved in difficult and prolonged negotiations with the Fund and other creditors, and drawings under its extended arrangement had been disallowed owing to policy excesses. Nonetheless, the Fund responded positively to a request for emergency assistance. In the remaining three cases (the two Yemens and the Solomon Islands), the authorities submitted statements of policy intentions along with their requests for assistance. In 1989, the staff reviewed the guidelines and concluded that the system was working well and could be continued without modification.[111]

Emergency Assistance in Financial Crises

On a few occasions in the early 1980s, the staff considered whether it might be possible to establish procedures for emergency assistance in response to financial crises. In January 1980, the Research Department proposed establishment of a "temporary intermediation facility" to provide low-conditionality loans quickly to countries facing a sudden loss of access to international bank credits. (See Chapter 13, pp. 560–63.) A year later, at the time of the Swedish exchange crisis of January 1981 (see Chapter 2), the European Department toyed with the idea of proposing a credit of up to $1 billion (148 percent of quota) to Sweden for up to six months. Once an adjustment program was negotiated, the credit could be rolled over into a stand-by arrangement. If the crisis passed with no need for an adjustment program, then the balance could be quickly repaid. Around the same time, the Deputy Managing Director, William Dale, proposed using temporary allocations of SDRs on an emergency basis to cope with threats to the stability of the international monetary system arising from debt-servicing problems in one or more

[110]The one exception—a credit of 50 percent of quota to the Yemen Arab Republic in March 1983—was made on the spur of the moment and, in a sense, accidentally. Yemen had suffered an estimated $1.8 billion in damages from a severe earthquake in December 1982. In response, the staff and the authorities had discussed a drawing that would be tiny in relation to the damage—approximately $5.3 million, or 25 percent of quota—and the staff report recommended that amount. By the time of the Board meeting, the authorities had not got around to submitting a formal request, so management arranged to ask Directors to approve the drawing in principle. In the course of the discussion, Casey asked whether consideration had been given to 50 percent, in view of the severity of the damage and the unusually small size of Yemen's quota. Mohamed Finaish (speaking for Yemen) quickly asked for 50 percent, and the Board approved that amount over the objections of four Directors. The authorities submitted a formal request a few days later, and the Board confirmed its approval without further discussion. See minutes of EBM/83/35 (February 23, 1983) and EBM/83/40 (February 28).

[111]"Review of Fund Policies with Regard to Emergency Assistance Related to Natural Disasters," EBS/89/69 (April 13, 1989).

large countries. De Larosière, however, reacted negatively to these various proposals, and no action was taken.[112]

In 1982, in the wake of the international debt crisis, the staff noted that "under the Fund's present policies, there are no special facilities that members can use in the event of a financial emergency arising from sudden, severe, and widespread strains in the international financial system." The Executive Board, however, concluded that it would be "inappropriate for the Fund to engage in short-term bridging financing in view of the possible risk of impairing the effectiveness of the Fund's adjustment programs."[113] The idea then was dropped for the remainder of the 1980s.

The general idea of lending to countries before a regular stand-by arrangement could be negotiated was revived in 1993 with the establishment of the Systemic Transformation Facility as a temporary vehicle for assisting economies in transition from central planning systems. The more specific idea of emergency financial assistance was revived in 1995 following the Mexican peso crisis, and interest in it intensified after the onset of the financial crisis in Asia two years later. The New Arrangements to Borrow and the Supplemental Reserve Facility that were approved in 1997 were designed to enable the Fund to respond more effectively in such situations.[114]

Appendix I: The CFF Cereals Window

In May 1981, the Fund established a window within the CFF to compensate countries for the cost of temporary increases in the cost of importing cereals. The text of the Decision is followed by some illustrative examples of how the facility was intended to work.

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[112]See memorandum from Dale to the Managing Director (January 26, 1981); IMF/CF (S 2110 "Special Drawing Rights, Decisions to Allocate, 4th Basic Period 1981–1982"). De Larosière's disinclination to support these various proposals stemmed from skepticism about their feasibility, not from lack of interest in the general idea. In July 1980, he asked the staff to prepare a confidential report assessing "the role which the Fund could play in the event of a sudden interruption in normal banking flows, whether because of a funding or a lending crisis. . . . This would try to identify where existing arrangements (BIS, national lenders of last resort) might be insufficient to cope with such developments, and suggest a detailed contingency plan for the Fund's possible role." Memorandum (July 10, 1980) to Walter O. Habermeier (Treasurer); IMF/RD (Historian's files). It appears, however, that no such report was prepared.

[113]"The Adequacy of Existing Arrangements to Deal with Major Strains in the International Financial System," EBS/82/194 (October 22, 1982); the quotation is from p. 37. See minutes of EBM/82/150–151 (November 19, 1982); the quotation is from the Chairman's summing up, p. 31 of meeting 82/151.

[114]The New Arrangements to Borrow (NAB) are an agreement by participants to lend to the Fund "when supplementary resources are needed to forestall or cope with an impairment of the international monetary system, or to deal with an exceptional situation that poses a threat to the stability of the system." The Supplemental Reserve Facility (SRF) was adopted "to provide financial assistance to a member country experiencing exceptional balance of payments difficulties due to a large short-term financing need resulting from a sudden and disruptive loss of market confidence reflected in pressure on the capital account and the member's reserves." The quotations are from the Fund's press releases announcing the relevant decisions.

Compensatory Financing of Fluctuations in the Cost of Cereal Imports

1. For an initial period of four years from May 13, 1981, the Fund will be prepared to extend financial assistance in accordance with the terms of this decision to members that encounter a balance of payments difficulty produced by an excess in the cost of their cereal imports. The amount of this financial assistance will be determined in accordance with this decision, which integrates this assistance with that available in accordance with the facility established by the decision on the compensatory financing of export fluctuations (Executive Board Decision No. 6224-(79/135)).

2. For a period of three years from the date of a member's first request for a purchase under this decision, any purchases by the member in respect of its export shortfalls shall be made under this decision instead of under Decision No. 6224.

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

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

(b) the member will cooperate with the Fund in an effort to find, where required, appropriate solutions for its balance of payments difficulties.

4. (a) Subject to the limits specified in paragraph 9, a member may request a purchase under this decision for an amount equal to the net shortfall in its exports calculated as the sum of its export shortfall and the excess in its cereal import costs.

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

(ii) An export shortfall shall be determined in accordance with Decision No. 6224.

(iii) An excess in cereal import costs shall be determined in accordance with paragraphs 5 and 6.

5. The existence and amount of an excess in the cost of cereal imports shall be determined, for the purpose of purchases under this decision, with respect to the latest 12-month period preceding the request for which the Fund has sufficient statistical data, provided that the Fund may allow a member to make a purchase on the basis of estimated data in respect of a 12-month period ending not later than 12 months after the latest month for which the Fund has sufficient statistical data on the member's cereal import costs. The estimates used for this purpose shall be made in consultation with the member. The calculation of a member's shortfall or excess in exports and its excess or shortfall in the cost of its cereal imports shall be made for the same 12-month period.

6. In order to identify more clearly what are to be regarded as excess costs of cereal imports of a short-term character, the Fund, in consultation with the member concerned, will seek to establish reasonable estimates regarding the medium-term trend of the member's cereal import costs. For the purposes of this decision, the excess in a member's cereal imports for the 12-month period referred to in paragraph 5 shall be the amount by which the member's cereal imports in that 12-month period are more than the arithmetic average of the member's cereal imports for the five-year period centered on that 12-month period.

7. The amount of a purchase under this decision, as defined in paragraph 4, may be either in relation to an export shortfall or to an excess in cereal import costs, or the amount may consist of two components, one relating to an export shortfall and the other relating to

an excess in cereal import costs. The total amount of the purchase and the amount of each component are subject to the limits specified in paragraph 9.

8. (a) The part of the purchase relating to an export shortfall, subject to the limit in paragraph 9(b), shall not exceed the lesser of the export shortfall defined in paragraph 4(b) (ii) and the net shortfall in exports defined in paragraph 4(a).

(b) The amount of a purchase relating to an excess in cereal import costs, subject to the limit in paragraph 9(c), shall not exceed the lesser of the excess in cereal import costs defined in paragraph 4(b) (iii) and the net shortfall in exports defined in paragraph 4(a).

9. (a) The total amount of a member's purchases outstanding under this decision and Decision No. 6224 shall not exceed an amount equal to 125 per cent of quota, provided that a request for a purchase that would increase the total amount of the member's purchases outstanding under this decision and Decision No. 6224 beyond 50 per cent of quota will be met only if the Fund is satisfied that the member has been cooperating with the Fund in an effort to find, where required, appropriate solutions for its balance of payments difficulties.

(b) The total amount of a member's purchases outstanding under Decision No. 6224 and this decision that are related to export shortfalls shall not exceed 100 per cent of quota.

(c) The total amount of a member's purchases outstanding under this decision that are related to the excess in cereal import costs shall not exceed 100 per cent of quota.

10. Where the sum of the export shortfall and cereal import components, as limited by paragraph 9(b) and paragraph 9(c), exceeds the limit specified in paragraph 9(a), the member shall allocate the amount of its purchase as between the two components.

11. Purchases under this decision and holdings resulting from such purchases shall be excluded pursuant to Article XXX(*c*) for the purpose of the definition of "reserve tranche purchase." For the purpose of applying the Fund's policies on the use of its resources, holdings resulting from the use of the Fund's resources under the policy set forth in this decision shall be considered to be separate from the holdings resulting from the use of the Fund's resources under any other policy, except the policy set forth in Decision No. 6224.

12. When a member requests a purchase on the basis of estimated statistical data the member will be expected to represent that, if the amount of the purchase exceeds the amount that could have been purchased on the basis of actual statistical data, the member will make a prompt repurchase in an amount equivalent to the overcompensation.

13. (a) Subject to paragraph 12, when a reduction in the Fund's holdings of a member's currency is attributed to a purchase under this decision the member shall attribute that reduction between the outstanding cereal import component and export shortfall component of the purchase.

(b) When the Fund's holdings of a member's currency resulting from a purchase under this decision or Decision No. 6224 are reduced by the member's repurchase or otherwise, the member's access to the Fund's resources under this decision will be restored *pro tanto*, subject to the limits in paragraph 9.

14. (a) After the expiration of the period referred to in paragraph 2, the total amount of the export shortfall components of a member's purchases outstanding under this decision shall be counted as having been purchased under Decision No. 6224, and the resulting total of the amounts outstanding under Decision No. 6224 and the cereal import components outstanding under this decision shall not exceed 125 per cent of quota.

(b) The provisions of Decision No. 6224 shall continue to apply to the export shortfall component of a purchase under this decision after the expiration of the period referred to in paragraph 2 or the expiration of this decision.

15. In order to implement the Fund's policies in connection with the financing of members' cereal import costs and the compensatory financing of export shortfalls, the fund will be prepared to waive the limit on the Fund's holdings of 200 per cent of quota, (i) when necessary to permit purchases to be made under this decision or (ii) to the extent that purchases are outstanding under this decision.

16. The Fund will indicate in an appropriate manner which purchases by a member are made pursuant to this decision, and the export shortfall component and the cereal import component of each.

17. The Executive Board will review this decision not later than June 30, 1983, and when quota increases under the Eighth General Review of Quotas become effective.

Decision No. 6860-(81/81), adopted May 13, 1981

Illustrations of the Functioning of the CFF Cereals Window

As an illustration of how the 1981 cereals window in the CFF handled cereal imports in relation to merchandise exports, consider the following system of equations:[115]

Let

$$S_x \doteq \bar{X} - X_t$$

$$E_m \doteq M_t - \bar{M}$$

$$S_n \doteq S_x - E_m$$

$$\ln\bar{X} = [\ln X_{t-2} + \ln X_{t-1} + \ln\tilde{X}_t + \varepsilon(\ln X_{t+1} + \ln X_{t+2})]/5$$

$$\bar{M} = [M_{t-2} + M_{t-1} + \tilde{M}_t + \varepsilon(M_{t+1} + M_{t+2})]/5$$

And define the following rules:

$$C_m = \max[0, \min(E_m, S_n, L_m, L - C_x)]$$

and $C_x = \max[0, \min(S_x, S_n, L_x, L - C_m)]$

or $C_x = \min(S_x, L_x)$ under the 1979 Decision;

where $L_m = 100 - L_0$

$L_x = 100 - L_0$

$L = 125 - L_0$

and L_0 = outstanding CFF obligations.

All data are measured in percent of the country's quota in the Fund. $\bar{X}$ and $\bar{M}$ are the calculated trend values of merchandise exports (X) and cereal imports (M); $\tilde{X}$ and $\tilde{M}$ are the estimated values for the shortfall year (t); and ε denotes a forecast value. Note that the trend value of merchandise exports is calculated as a geometric average, while the trend value of cereal imports is calculated as an arithmetic average. S_x and E_m are the calculated export

[115]For the detailed mathematical framework of the basic operation of the CFF before the establishment of the cereals window, see Goreux (1980), Appendix III.

shortfall and import excess, respectively; S_n is the calculated net export shortfall; and C_x and C_m are the allowed compensation levels under the export shortfall and cereals windows, respectively.

For illustration, assume $\bar{X} - \bar{M} = 500$ and $L_0 = 0$.

Case #1: The country has both an export shortfall (say, $X_t = 420$) and excess import costs ($M_t = 580$) and is constrained by the lending limits.

Then $S_x = 80$, $E_m = 80$, and $S_n = 160$
and

$$C_x = \min(80, 160, 125 - C_m) \text{ and } C_m = \min(80, 160, 125 - C_x).$$

In this case, the country is entitled to borrow the maximum amount, 125, and can choose how to divide the total between the two windows as long as no more than 80 is borrowed from either window.

Case #2: The country has a sizable export shortfall and a small excess in cereal imports: $X_t = 450$ and $M_t = 510$.

Then $S_x = 50$, $E_m = 10$, and $S_n = 60$
and

$$C_x = \min(50, 100, 125 - C_m) = 50, \text{ and } C_m = \min(10, 100, 125 - C_x) = 10.$$

In this case, the country is entitled to full compensation for the combined shortfall (60), but by doing so it loses the option of using the 1979 rules if it subsequently suffers a gross (but not a net) export shortfall. Alternatively, it can borrow 50 now, using the 1979 rules, and keep open the possibility of using the cereals window at a later date. Now suppose that in the following year, the country has $X_t = 450$ and $M_t = 550$.

Then $S_x = 50$, $E_m = -50$, and $S_n = 0$
and

$$C_m = 0, \text{ and } C_x = \min(50, 100-50) = 50 \text{ under the 1979 Decision.}$$

Thus by limiting its borrowings to 50 in the first year, the country keeps open the possibility of borrowing a larger total amount (100) over two years.

Case #3: The country has an export shortfall, but its cereal imports are below trend by the same amount: $X_t = M_t = 420$.

Then $S_x = 80$, $S_m = -80$, and $S_n = 0$.

In this case, because the net shortfall is zero, the country is entitled to no compensation under the 1981 rules but can still apply for compensation of 80 under the 1979 rules.

Case #4: The country has an export shortfall, but its cereal imports are below trend by a lesser amount: $X_t = 420$ and $M_t = 480$.

Then $S_x = 80$, $S_m = -20$, and $S_n = 60$.

In this case, $C_m = 0$ and the country can choose between $C_x = 60$ (the net shortfall) under the 1981 rules or $C_x = 80$ (the gross shortfall) under the 1979 rules. Since choosing the old rules leaves open the possibility of using the cereals window if $C_m > 0$ for a subsequent year, the country normally will choose the larger amount in this case.

Case #5: The country has above-trend exports that offset its excess costs of cereal imports: $X_t = M_t = 580$.

Then $S_x = -80$, $S_m = 80$, and $S_n = 0$.

In this case, the country is entitled to no compensation, because the 1979 rules do not apply to cereal imports.

Case #6: The country has above-trend exports that only partially offset its excess costs of cereal imports: $X_t = 520$ *and* $M_t = 580$.

Then $S_x = -20$, $S_m = 80$, and $S_n = 60$.

In this case, the country is entitled to compensation for its net excess cereals costs: $C_m = 60$.

Appendix II: Emergency Assistance for Natural Disasters

When the Fund decided in February 1982 not to establish a special facility for disaster relief, it adopted general guidelines for granting assistance to countries hit by natural disasters.

The Managing Director's concluding remarks at EBM/82/16 (February 10, 1982), pp. 17–18, included the following text:

> I think the best thing we can do at this stage is to note the support for the flexible practices that have been used in the past and have been incorporated in the language of Section III of [Fund Policies with Regard to Emergency Assistance Related to Natural Disasters, (SM/82/7, January 8, 1982)] . . .
>
> One of the advantages of the method already in use is that the management is allowed to exercise discretion and judgment on what constitutes a disaster serious enough to make a country eligible for emergency assistance from the Fund. The staff and management might miss some of the important points, but close contact with the Executive Directors concerned would enable them to receive good guidance on whether a given series of events crosses the threshold of disaster. Judgments will have to be made on the gravity of the situation, on the impact on the balance of payments, and on the type of help the Fund can offer the country in question. Such judgments would not fit easily into a set of rigid guidelines. The present language of Section III [below] seems appropriate, because it gives the staff and management general guidance while leaving them the necessary flexibility. In any event, it is the Board that will decide on each particular case. I am sure that the Board will be happy to have, not a legal document, but some guidelines to use as yardsticks in reaching those decisions.

The text to which those remarks referred read as follows:

> **III. Issues for Consideration by the Executive Board**
>
> The review of experience suggests that effective emergency assistance can continue to be provided to members afflicted by natural disasters through a flexible application of the existing policies on use of Fund's resources. There is, therefore, no need in the staff's judgment for establishing a new facility specifically addressed to cases of emergency. Executive Directors may wish to consider the following broad guidelines for the provision of emergency assistance to members afflicted by natural disasters.

(a) In most cases in which a member is afflicted by a natural disaster, effective assistance would continue to be provided by purchases under the compensatory financing facility or by stand-by and extended arrangements. However, in those cases where a member cannot meet its immediate financing needs arising from a major disaster, such as flood, earthquake, or hurricane, without serious depletion of its external reserves, emergency assistance in the form of quick outright purchases would continue, as in the past, to be provided under a flexible application of tranche policies.

(b) Emergency assistance is designed to provide only limited foreign exchange required for immediate relief. In the past, outright purchases for emergency situations were provided for relatively moderate amounts. In half of the cases, such purchases amounted to 25 percent of quota; in the remaining half, purchases ranged from 42–50 percent of quotas. On the basis of experience, the amount of resources would continue to be limited to the equivalent of one credit tranche, though larger amounts could be made exceptionally available. When need for additional financing is present, it would be best provided under the compensatory financing facility and within the framework of stand-by and extended arrangements.

(c) The amount of an emergency purchase would be taken into account in determining the size of any additional support under a subsequent stand-by or extended arrangement. Moreover, in order to avoid double compensation in cases where a member requests a CFF purchase subsequent to an emergency purchase, a determination would be made at the time of the CFF request of the part of export shortfall on which the CFF request is based that has already been compensated by the emergency purchase. In accordance with the procedures suggested in the Appendix, that part would be deducted from the calculated shortfall and an equivalent amount of the emergency purchase would be reclassified as a CFF purchase.

(d) In emergency situations, timing is crucial; quick assistance from the Fund can both provide relief and encourage financing from other sources. While in most instances, balance of payments difficulties will be transitory, understandings are needed to ensure that inappropriate policies do not compound the problems caused by the disaster. As in the past, a flexible and pragmatic approach will be followed to take into account the particular circumstances of the country, the nature and the extent of the disaster and the need to safeguard the revolving character of Fund resources.

(e) For purposes of emergency assistance requests, a member would be required to describe the general policies it plans to pursue, including its intention to avoid introducing or intensifying exchange and trade restrictions. The request will be granted when the Fund is satisfied that the member will cooperate with the Fund in an effort to find, where appropriate, solutions for its balance of payments difficulties. Frequently, at the time of the request of emergency assistance, members expressed an intention to devise adjustment programs in consultation with the Fund, but this intention was seldom carried out. To strengthen this aspect of the Fund's emergency assistance, the member's cooperation with the Fund in designing and adopting, when appropriate and as soon as circumstances permit, necessary adjustment measures would be one of the elements to be considered in the assessment of the requirement of cooperation associated with CFF purchases in the upper tranche. Such an approach would be applied so as to allow the assessment of cooperation to continue to be made on a pragmatic basis in the light of the nature of the difficulties and the circumstances of the member.

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