INTERNATIONAL MONETARY FUND

IMF POLICY PAPER

November 2016

FINANCING FOR DEVELOPMENT: ENHANCING THE FINANCIAL SAFETY NET FOR DEVELOPING COUNTRIES—FURTHER CONSIDERATIONS

IMF staff regularly produces papers proposing new IMF policies, exploring options for reform, or reviewing existing IMF policies and operations. The following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its November 16, 2016 consideration of the staff report.
- The **Staff Report**, prepared by IMF staff and completed on October 24, 2016 for the Executive Board's consideration on November 16, 2016.

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INTERNATIONAL MONETARY FUND

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IMF Executive Board Provides Further Guidance to Enhance the Financial Safety Net for Developing Countries

On November 16, 2016, the Executive Board of the International Monetary Fund (IMF) discussed a staff paper on "*Financing for Development: Enhancing the Financial Safety Net for Developing Countries – Further Considerations*", which identifies areas where current guidance on Fund policies needs to be clarified in regard to the access of developing countries to financial support from the Fund.

The staff paper examines a number of issues raised by Executive Directors and by the International Monetary and Financial Committee (IMFC) since the issuance to the Board in June 2015 of a staff paper on *"Financing for Development: Enhancing the Financial Safety Net for Developing Countries."* That paper had proposed a number of measures to expand access to Fund resources for developing countries, including a 50 percent increase in access limits to Fund concessional resources for those members deemed eligible to access the facilities supported by the Fund's Poverty Reduction and Growth Trust (PRGT) – a proposal that was endorsed by the Board on July 1, 2015.

The new paper provides clarification on a number of issues pertaining to access to Fund resources for PRGT-eligible members. The issues examined include: a) access of PRGT-eligible members to Fund instruments that draw on the General Resources Account (GRA); b) the role of access norms in providing indicative guidance on what could constitute the appropriate level of access; c) the adequacy of PRGT-eligible members' access to precautionary financial support; and d) the adequacy of safeguards to prevent repeated use of the Rapid Credit Facility (RCF) as a substitute for arrangements with ex post conditionality.

The paper does not propose specific reforms to the Fund's concessional facilities at this juncture. A comprehensive review of PRGT resources and facilities is planned for 2018.

Executive Board Assessment[1]

Executive Directors welcomed the opportunity to discuss the Fund's policies and practices in regard to the access of PRGT-eligible members to the Fund's concessional and GRA resources, as called for by the International Monetary and Financial Committee (IMFC) at its Spring 2016 meeting. Directors agreed that the current concessional financing toolkit is generally well calibrated, and appreciated clarification of existing policies and the revisions underway to the Low-Income Countries Handbook.

Directors reaffirmed that a PRGT-eligible member has the right to access GRA resources on the same conditions as any other Fund member. They also noted that, given the financial benefits to the member from borrowing on concessional terms, staff should continue to advise PRGT-eligible members considering Fund financial support to seek support from the PRGT up to the applicable limits before seeking GRA resources.

Directors welcomed the clarification of the current policy on blending. They agreed that the presumption of blending PRGT with GRA resources should continue to be applied to PRGT-eligible members meeting the income or market access thresholds for blending; these countries would have access to PRGT resources only in conjunction with access to GRA resources. Directors also agreed that this presumption does not normally apply where the member is in debt distress or at high risk of debt distress.

Directors noted that PRGT-eligible members that are not presumed to blend can access PRGT resources exclusively up to the applicable PRGT access limits. They also noted that these members, to the extent that they meet the applicable policies on access to GRA resources, are not precluded from accessing these resources, either on a standalone basis or in conjunction with PRGT resources.

Directors reaffirmed that access to GRA resources is subject to the general policies governing GRA access and that total access to Fund resources (the sum of GRA and PRGT resources made available) should be determined case by case on the basis of the standard criteria, including balance of payments need, program strength, and capacity to repay the Fund, informed by debt sustainability analysis. Many Directors encouraged the staff to be more open to considering requests for higher levels of access to Fund resources as allowed within the current access rules, while safeguarding the Fund's resources. Some Directors noted that this was of particular relevance in the current juncture, where a number of low-income and frontier market economies had sizeable financing needs that could well exceed the applicable PRGT limits.

[1] An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

Directors underscored that access norms, as used in PRGT facilities, are neither a ceiling nor a floor on the level of access provided in PRGT-supported arrangements. Norms should help to inform the assessment of access levels but should not be misconstrued as access limits or entitlements.

Directors agreed that the record of usage of the Rapid Credit Facility (RCF) suggests that the existing safeguards are adequate to prevent repeated use of the RCF as a substitute for arrangements with ex post conditionality and called for continued monitoring in this regard. For countries receiving support under the RCF that are also seeking to build a track record toward an upper credit tranche (UCT)-quality program, Directors agreed that the use of a staff-monitored program (SMP) to build such a track record would normally be the preferred option, while noting an assessment of the policy commitments made in the context of disbursements under the RCF could also be used for that purpose. Hence, a number of Directors underscored that use of an SMP to build a track record in such circumstances, while preferable, should not be required, providing flexibility to accommodate individual country circumstances.

Directors were of the view that the existing array of Fund facilities provided substantial room to provide PRGT-eligible members with Fund support on a precautionary basis. Most Directors did not see a need to establish new facilities in the PRGT targeted specifically at providing precautionary support to PRGT-eligible members at this juncture.

Directors emphasized the importance of continued attention to maintaining the adequacy and flexibility of the PRGT lending toolkit, including by reviewing access norms and limits, blending policy, interest rate structure, and safeguarding mechanisms for maintaining the self-sustaining capacity of the PRGT. In this regard, they looked forward to the planned comprehensive review of PRGT resources and facilities in 2018, in accordance with the normal five-year cycle for such reviews, as well as the upcoming meeting on the Fund’s role in assisting small states build resilience to natural disasters and climate change.

INTERNATIONAL MONETARY FUND

October 24, 2016

FINANCING FOR DEVELOPMENT: ENHANCING THE FINANCIAL SAFETY NET FOR DEVELOPING COUNTRIES—FURTHER CONSIDERATIONS

EXECUTIVE SUMMARY

PRGT-eligible members make considerable use of Fund concessional financing. Since 2010, 56 percent of Fund arrangements have involved a PRGT-facility.

This paper examines a number of issues raised by Executive Directors and the International Monetary and Financial Committee (IMFC) since the issuance to the Board of the June 2015 staff paper on enhancing the financial safety net for developing countries (IMF, 2015a).

This paper concludes that there is a need to clarify guidance in some areas pertaining to PRGT policies. This will be done through an early revision of the LIC Handbook, which is already underway. The paper does not propose changes to the Fund's concessional facilities at this juncture. A comprehensive review of PRGT (Poverty Reduction and Growth Trust) resources and facilities is planned for 2018.

In particular, the paper discusses the need to clarify guidance on existing access policies as they relate to PRGT-eligible members as follows:

- *Access to General Resources Account (GRA) resources*. A PRGT-eligible member has the right to access GRA resources on the same conditions as any other Fund member. Given the financial benefits from borrowing on concessional terms, staff will continue to advise PRGT-eligible members considering Fund financial support to borrow from the PRGT up to the applicable limits before seeking GRA resources.

- *Blending*. A third of PRGT-eligible members are presumed blenders, in the sense that they are expected to access a mix of GRA and PRGT resources. Other PRGT-eligible members (non-presumed blenders) are entitled to seek wholly concessional support up to the applicable access limits. These non-presumed blenders may also blend, subject to an assessment, as in all cases of Fund financing, of balance-of-payments (BoP) need, program strength, capacity to repay the Fund and debt sustainability.

- *Access norms.* Norms provide indicative guidance on what could constitute an appropriate level of access under PRGT facilities, but they should neither formally

restrict nor ensure specific access levels. Access should continue to be determined on a case-by-case basis using the standard criteria.

The paper also discusses some specific issues relating to the existing facilities:

- *Precautionary Support.* At this time, staff does not see a case for establishing new concessional facilities targeted specifically at meeting the precautionary needs of PRGT-eligible members.

- *Rapid Credit Facility (RCF) repeated use*. Staff considers that existing safeguards are adequate to prevent repeated use of the RCF as a substitute for arrangements with ex post conditionality.

- *RCF and Staff-Monitored Program (SMP)*. For countries receiving support under the RCF that are also seeking to build a track record towards an upper credit tranche (UCT)-quality program, staff will more systematically promote the use of SMP for track record purposes, in place of policy commitments made under the RCF.

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CONTENTS

Acronyms and Abbreviations

BoP	Balance of Payment
ECF	Extended Credit Facility
GFSN	Global Financial Safety Net
GNI	Gross National Income
GRA	General Resources Account
IDA	International Development Association
IMFC	International Monetary and Financial Committee
LICs	Low-Income Countries
NPB	Non-Presumed Blenders
PPP	Purchasing Power Parity
PRGT	Poverty Reduction and Growth Trust
PSI	Policy Support Instrument
RCF	Rapid Credit Facility
RFI	Rapid Financing Instrument
SBA	Stand-By Arrangement
SCF	Standby Credit Facility
SMP	Staff-Monitored Program
UCT	Upper Credit Tranche

INTRODUCTION AND MOTIVATION

1. Low-income countries (LICs) make considerable use of the Fund's concessional financing facilities. Since the overhaul of the Fund's concessional facilities in 2009, 35 members have had arrangements supported through the Poverty Reduction and Growth Trust (PRGT), which is used to finance the Fund's concessional lending; the 60 arrangements supported by the PRGT accounted for 53 percent of all Fund arrangements in the period.

2. The International Monetary and Financial Committee (IMFC) and Executive Directors have called for the examination of some practices in regard to Fund financing of PRGT-eligible members. The April 2016 IMFC Communique called for an examination of current practices in regard to the blending of PRGT and General Resources Account (GRA) resources as well as the adequacy of PRGT-eligible members' access to precautionary financial support. Also, during the Executive Board's discussion on "*Financing for Development: Enhancing the Financial Safety Net for Developing Countries*" (IMF, 2015a) on July 1, 2015, some Directors drew attention to the risks of "facilities shopping," expressing concern at the scope for repeated use of the Rapid Credit Facility (RCF), which has no ex post conditionality, instead of a regular Fund arrangement (IMF, 2015c). Other issues raised include: (i) clarifying access to the GRA by PRGT-eligible members; (ii) the adequacy of facilities for supporting small-state members hit by severe natural disasters; and (iii) the role of the Staff Monitored Program (SMP) as the preferred vehicle to build a track record to an Upper Credit Tranche (UCT)-quality arrangement in cases where countries are making RCF requests to meet immediate urgent balance of payments (BoP) needs while also seeking to build such a track record. Concerns were also expressed as to the adequacy of PRGT access norms and limits in relation to the macroeconomic challenges faced by PRGT-eligible members.

3. This paper examines the issues raised by the IMFC and by Executive Directors during and subsequent to the Board discussion on financing for development. The paper does not propose changes to the Fund's concessional facilities, but concludes that there is a need for greater clarity regarding some of the existing policies and the principles that underlie them. The clarifications outlined below will be used to sharpen the relevant guidance to staff, including as contained in the LIC Handbook.[1] A comprehensive review of PRGT resources and facilities is planned for 2018.[2]

4. The remainder of this paper proceeds as follows: Section II discusses access of PRGT-eligible members to GRA facilities and instruments, including through blending; Section III examines the role PRGT access norms play under PRGT facilities; Section IV considers the adequacy of existing instruments for providing precautionary financial support to PRGT-eligible members; Section V discusses modalities of and past experience with RCF use, including moral hazard issues and the use

[1] See The 2016 Handbook of IMF Facilities for Low-Income Countries (IMF, 2016a).

[2] Among other issues, this review will look into the merits and feasibility of unifying the interest rates charged on loans extended under the Standby Credit Facility (SCF) and Extended Credit Facility (ECF), responding to calls from Executive Directors during the 2016 Review of the PRGT Interest Rate Structure, concluded on October 3rd, 2016.

of the RCF to build a track record of strong economic performance; Section VI presents conclusions, while Section VII proposes issues for discussion.

GENERAL PRINCIPLES GUIDING ACCESS

A. Access to GRA Facilities

5. Under the Articles of Agreement, all Fund members are eligible to access the Fund's resources in the GRA.[3] All members requesting access to Fund financial support from the GRA are required to meet the provisions of the Articles of Agreement as well as the policies adopted thereunder, including those intended to safeguard the temporary use of the Fund's general resources. These policies do not distinguish among members on the basis of per capita income.[4]

6. A subset of Fund members also has access to concessional financing support from the PRGT. Concessional financing is available to developing countries that meet certain income and market access criteria; the list of PRGT-eligible members is reviewed every two years, with the next review scheduled for 2017.[5] Currently 69 members are deemed to be PRGT-eligible—a grouping that accounts for around 2.7 percent of world GDP (PPP-basis) and 14.5 percent of the world's population. PRGT-eligible members are not obliged to use PRGT financing and, as noted above, can access GRA resources on the same terms as other members. That said, loans provided through PRGT-supported facilities carry more favorable terms than are available under the GRA—specifically, PRGT financing carries lower interest rates, longer maturities, and longer grace periods. Given these financial advantages, PRGT-eligible members considering Fund financial support are encouraged to borrow first from the PRGT up to the applicable access limits.[6] If the size of the balance of payments need exceeds the access limits of the PRGT, or if the member prefers to access GRA resources, consideration of a request for support from the GRA would be based on the relevant policies governing access to the GRA.

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[3] Article V, Section 3(b) of the Fund's Articles of Agreement.

[4] As a corollary, any reforms of the toolkit of GRA instruments affect both PRGT-eligible member countries and other members alike.

[5] The last review was completed in July 2015. See *Eligibility to Use the Fund's Facilities for Concessional Financing, 2015*.

[6] *The Fund's Support of Low-Income Member Countries—Considerations on Instruments and Financing*, 2004 (paragraphs 27-28 and Box 4;IMF (2004b), 04/07/2004), *The Fund's Facilities and Financing Framework for Low-Income Countries*, 2009 (footnote 40), and *Review of Facilities for Low-Income Countries*, 2012 (Appendix II).

B. Blended Access to GRA and PRGT Resources

7. PRGT-eligible members may blend support from GRA and PRGT resources. Given the scarcity of concessional resources, the Fund has established a PRGT policy that limits access to PRGT resources when the member meets certain criteria, generally high income and/or market access (see Box 1). Under this policy, for a PRGT-eligible member meeting the applicable criteria, there is a presumption of blending; that is, the Fund will generally not provide financial support exclusively on concessional terms, even if their needs could be met within the normal access limits of the PRGT. Accordingly, under this policy, there are two sub-groups of PRGT-eligible members: (i) members that are "presumed blenders" and (ii) members that are not presumed to blend (NPB).

8. Members that are "presumed blenders" are expected to access PRGT resources only via a mix of PRGT and GRA resources. Box 1 describes the criteria applied to determine whether a member is a presumed blender and the rules determining the mix of PRGT and GRA resources made available to such members. Currently, 23 of the 69 PRGT-eligible members fall into this grouping.[7]

Box 1. Presumed Blenders

This box discusses the criteria to determine which members are presumed blenders and, for presumed blenders, the blending ratio and access amounts.

- *Criteria to determine which members are presumed blenders*. PRGT-eligible members are presumed to blend if their per capita Gross National Income (GNI) either exceeds (i) 100 percent of the International Development Association (IDA) operational cutoff, or (ii) 80 percent of the IDA operational cutoff if they also have market access. A member is deemed to have market access for blending purposes if it has sustained past and prospective access to non-concessional lending from capital markets and official lenders. A member at high risk of debt distress or in debt distress is not normally to be treated as a presumed blender.
- *Blending ratio*. Up to a cap on access to concessional resources, the mix of funding between PRGT and GRA resources is 1:2 (PRGT:GRA); above this cap, any incremental financing is sourced entirely from the GRA. The cap on access to concessional resources depends on the type of facility and is set at the applicable norm for the SCF and the ECF and the applicable access limit for the RCF. These caps are summarized in Table 1 and described in further detail in the LIC Handbook.
- *Amount of access*. Total access to Fund resources (GRA and PRGT combined) is determined based on the standard criteria outlined in paragraph 11. Thus, the same criteria apply whether the financial support comes in the form of either blended or PRGT-only resources.

[7] As of end-August 2016, 37 PRGT-eligible members meet the income and market access criteria under the blending policies. However, 14 of these members are assessed to be at high risk of debt distress or in debt distress and thus not presumed to blend.

9. Members that are not presumed to blend can access PRGT resources exclusively up to the applicable PRGT access limits: they are not precluded from requesting GRA resources, but it is expected that they would first seek to meet their balance of payments needs through the PRGT facilities.[8]

- Access to PRGT resources under the various concessional facilities is subject to the applicable PRGT access limits. As further explained below, when NPB members receiving PRGT support have balance of payments needs that exceed these limits, those needs can be met from the GRA.

- Access to GRA resources remain subject to the general policies governing GRA access; total access (the sum of GRA and PRGT resources made available) is determined on the basis of the standard criteria described in paragraph 12.

10. The Fund has noted that for PRGT-eligible members with weak capacity to service non-concessional debt, GRA financing may not be suitable, relative to concessional financing under the PRGT.[9] This is so because of the higher interest rates and shorter maturities of financing in the GRA. This concern over capacity to service debt is addressed under Fund policy through a rigorous assessment of capacity to repay, and applies to all members of the Fund.

11. Staff will clarify the existing blending policy in the LIC Handbook. In particular, staff will clarify the current language on blending, which specifies, in part, that "in exceptional circumstances, when financing needs exceed the applicable access limits—notably in cases of clearance of protracted arrears to the Fund—blending could be used irrespective of the per capita income, market access, and debt sustainability criteria."[10] This text applies to the situation of a PRGT-eligible member that is not a presumed blender and therefore may meet its needs fully from the PRGT as noted above. However, given that its financing needs exceed the applicable PRGT access limits, it will be expected to blend with the GRA. Accordingly, it will be clarified that the "exceptional circumstances" wording reflects the rarity of cases when financing needs exceed the applicable PRGT access limits and should not be considered as an indication that only in exceptional cases may certain members access the GRA; and that application of the clause is not limited only to cases of arrears clearance. Moreover, every PRGT-eligible member, whether a presumed blender or not, has access to resources in the GRA, provided that it meets applicable GRA policies, including those that pertain to program strength, capacity to repay the Fund and debt sustainability.

[8] See Footnote 6.

[9] See IMF (2004b) (04/07/2004) and *Strengthening the Fund's Ability to Assist Low-Income Countries Meet Balance of Payments Needs Arising from Sudden and Exogenous Shocks* (IMF (2005), 06/10/2005).

[10] See IMF (2009b), paragraph 92.

PRGT ACCESS AND THE ROLE OF NORMS

12. The level of Fund financial assistance to PRGT-eligible members is determined using the standard criteria that apply to all Fund financing. Access to Fund resources is determined on a case-by-case basis, by: (i) the size of the balance of payments need; (ii) the strength of the authorities' program; (iii) the capacity to repay; and (iv) Fund credit outstanding and track record of past use. All else being equal, higher access would generally be associated with a stronger program, stronger track record, and stronger capacity to repay. These criteria apply to all members whether they are accessing PRGT resources, GRA resources, or some mix of the two. While assessment has to be made on a case-by-case basis and uniform application of the standard criteria needs to be ensured, the debt sustainability analysis, including risk assessment and risk outlook, is expected to provide relevant information in this process.

13. Financial assistance from PRGT resources is subject to access limits, including hard limits for exceptional access *(see Appendix Table 1)*. To qualify for PRGT exceptional access, a member has to be assessed as having income at or below the prevailing International Development Association (IDA) operational cutoff;[11] and that it (i) faces an exceptionally large balance of payments need, (ii) has a comparatively strong adjustment program and ability to repay the Fund,[12] and (iii) does not have sustained past and prospective access to capital markets. Exceptional PRGT access is capped at 300 percent of quota on a cumulative basis net of scheduled repayments and at 100 percent on an annual basis.[13]

14. Access norms, which apply only to PRGT financing, are intended to provide general guidance. Norms are neither ceilings nor floors to access, and they should not be viewed as entitlements. They are lower for members with significant outstanding PRGT credit, given that concessional resources are scarce. Norms can play a useful guiding role in setting access in cases where it is difficult to accurately determine the balance of payments need. Norms also play an important role in the calculations to estimate the self-sustained annual level of concessional lending from the PRGT. Specifically, average access at the norm should not pose risks to the robustness of PRGT self-sustainability for projected demand (expressed as a percent of eligible members seeking Fund support) under a range of plausible circumstances. For presumed blenders, the norm also serves as the cap for financing from PRGT resources (see Box 1). Since 2010, 42 percent of Standby-Credit Facility/Extended Credit Facility (SCF/ECF) supported programs have involved access at the

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[11] The IDA per capita income operational cut-off is the ceiling for IDA eligibility. It is revised each year, typically in July.

[12] The strong adjustment program and ability to repay would *generally* not be met by members with a high risk of debt distress (or in debt distress), unless expected debt relief or restructuring is projected to reduce the risk of debt distress to a moderate or low level. (See *A New Architecture of Facilities for Low-Income Countries*, 2009).

[13] For GRA resources exceptional access is not capped. The exceptional access policy is triggered when access is above 145 percent of quota on annual basis or 435 percent on a cumulative basis, net of scheduled purchases.

norm, 38 percent access below the norm (all cases involving states in a fragile situation), and 20 percent above the norm (Box 2).

15. Staff will strengthen the existing guidance on the use of PRGT access norms. Specifically, norms should neither automatically restrict nor extend access, which should be determined on a case-by-case basis as described above in paragraph 11. Thus, norms should help to inform assessments of access levels, but should not be misconstrued as access limits or entitlements. In practice, one would expect to observe significant variation of access relative to the norm.

ACCESS TO PRECAUTIONARY FINANCIAL SUPPORT

16. PRGT-eligible members can use the SCF either on a precautionary or a disbursing basis. For example, use of the SCF on a precautionary basis would be appropriate to address a potential short-term balance of payments need. During the course of an SCF arrangement, if unexpected and acute balance of payment needs arise that exceed the size of the arrangement, the authorities can request an augmentation.[14] LICs without an actual or potential balance of payment need can request non-financial assistance under the Policy Support Instrument (PSI).[15]

17. A handful of PRGT-eligible members have used arrangements on a precautionary basis. Stand-alone precautionary SCFs were approved for the Solomon Islands (2011) and Tanzania (2012); both countries eventually drew some of the available precautionary financing. Blended precautionary SCF and SBA arrangements were approved for Honduras (2010 and 2014), Georgia (2012), and Kenya (2015 and 2016); to date, no amounts have been drawn under these arrangements. The large financing package made available to Kenya in 2016 (involving access equivalent to 196 percent of quota) illustrates how existing facilities and policies can be used to provide significant precautionary support to PRGT-eligible members.

[14] The augmentation can be approved rapidly at an ad hoc review between scheduled reviews to address an increase in the underlying balance of payments problems that is so acute that the augmentation cannot wait until the next scheduled review under the arrangement, provided that all other policy requirements are met.

[15] The PSI is for policy advice and signaling, and (i) supports LICs that are in a broadly stable macroeconomic position at the time of the approval and thus do not need IMF financial assistance; and (ii) can provide accelerated access to the SCF in case of subsequent financial needs. Since 2010, 6 members have requested 11 PSIs.

Box 2. PRGT and GRA Facilities: Data on Usage

This box compares the experience with recent use of PRGT and GRA resources.

The pattern of Fund engagement differs significantly between members that are not PRGT-eligible ("GRA-only") and those that are PRGT eligible. Protracted program engagement is more prevalent with PRGT-eligible members in light of longer-term development financing needs for which Fund financial support is expected to play a catalytic role; non-PRGT-eligible members make more episodic use of Fund resources (Table below). PRGT-eligible members, who typically have only limited access to capital markets, are less likely to be subject to capital flow "sudden stops" that trigger the need for high access levels under the GRA—although frontier market economies are increasingly vulnerable to capital flow shocks. Access by non-PRGT-eligible members has typically been higher in quota terms, particularly in periods of global financial stress (Figure 1). In contrast, PRGT-eligible members generally face smaller balance of payments needs that can be met through more modest levels of financial support, spread over the medium term. Consistent with this, average annual access (expressed as a share of GDP) in PRGT-supported programs tends to be lower in general, but with considerable variation (Figure 2).

Longer-Term Program Engagement, July 2004–July 2014
(Share of countries)

Length of engagement (number of years)	PRGT	GRA
No program engagement	17.2	63.2
[<4]	32.8	26.4
[4-7]	31.3	10.3
[>=7]	18.8	0.0

Figure 1. Average Annual Access
(Percent of quota)

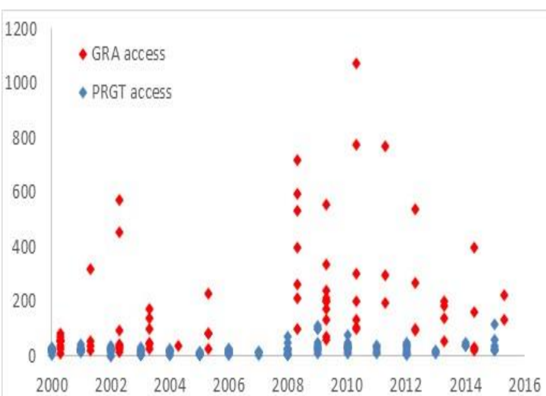
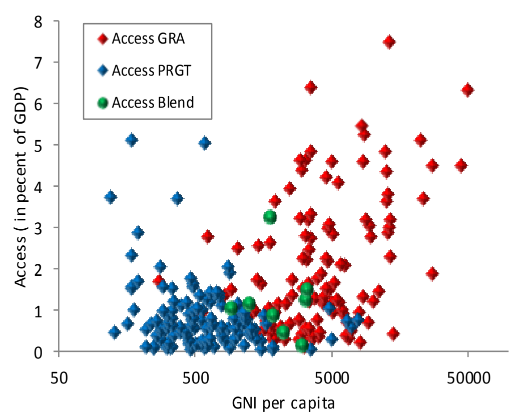


Figure 2. Average Annual Access Relative to GNI per Capita, 2000–15
(Percent of GDP)



18. At this juncture, staff does not see a case for establishing new concessional precautionary facilities targeted specifically at PRGT-eligible members. For presumed blenders, the scope to blend PRGT and GRA resources (through an SCF and SBA blend) already provides PRGT-eligible members with sufficient financing—including on a precautionary basis—to meet potential balance of payment needs. For non-presumed blenders, precautionary financing is available through the SCF, up to the prevailing access limits; additional financing, if needed, could be provided through a precautionary Stand-By Arrangement (SBA). PRGT-eligible members may request access under any other GRA facility or instrument, provided that they meet the qualification criteria. Against this backdrop, staff does not see a need at present to create a new precautionary instrument within the PRGT-financed set of facilities. This assessment could be revisited if there were to be changes to the GRA toolkit that assist members facing potential balance of payments needs on a precautionary basis.[16]

REPEATED USE OF THE RCF

19. The RCF provides rapid concessional financial assistance with limited conditionality to PRGT-eligible members facing an urgent balance of payments need.[17] Some features of the RCF have raised concerns about potential moral hazard or "facilities shopping" (the latter referring to repeated use of the RCF in lieu of adopting a conventional multiple-disbursement Fund arrangement involving UCT-quality policies with later disbursements subject to reviews and ex post conditionality). These concerns come about because, while RCF disbursements are often one-off, there is some constrained scope for repeated use. Specifically, repeated use of the RCF within any three-year period is possible if (i) the balance of payments need is caused primarily by an exogenous shock or (ii) the country has established a track record of adequate macroeconomic policies for a period of about six months prior to the request. However, no more than two disbursements may be made in any 12-month period.

20. The RCF has enhanced the Fund's ability to engage more flexibly with members in fragile situations. The RCF can be used by members in which a full-fledged economic program is not feasible, for instance because of capacity constraints or domestic fragilities. Repeated use of the RCF could help meet urgent balance of payments needs during the initial transition phases in many cases of entrenched fragility in LICs.[18] The RCF may also facilitate eventual transition to an ECF arrangement.

21. In staff's view, the existing safeguards are adequate to prevent repeated use of the RCF as a substitute for a conventional arrangement (such as an ECF or SCF) with ex post conditionality. Analysis of past usage does not point to any misuse of the RCF or "facilities shopping" (Box 3). Importantly, the three members that made repeated use of the RCF through the

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[16] It can be noted, again, that PRGT-eligible members would have access to any new GRA facilities under the same terms and conditions as members that are not PRGT eligible.

[17] For more detail on RCF see A New Architecture of Facilities for Low-Income Countries, IMF (2009b).

[18] See Macroeconomic and Operational Challenges in Countries in Fragile Situations, June 2011.

"normal window" were fragile states that used the RCF to meet urgent balance of payments needs while building a track record for a UCT-quality arrangement. All three, moreover, also moved to a longer-term engagement with the Fund. The monitoring framework established at the time of RCF requests has been used consistently to help members build a track records for a UCT-quality program. This has been done either in the form of an SMP or through informal monitoring targets that the authorities set for their own purposes and that were described in the Letter of Intent.

22. Staff will promote the use of SMPs, rather than policy commitments under the RCF, to build a track record towards a UCT-quality program. The SMP is designed to provide a clear and explicit framework to establish a policy track record that can facilitate an eventual transition to a UCT-quality program—an approach that is generally preferable to relying on the more ad hoc approach of setting monitorable targets in the RCF, which can be confusing as the RCF has no formal ex post conditionality. With regard to the policy track record required to support a repeat RCF disbursement request, the current framework remains adequate; the track record may be based on policy commitments in the context of a recent RCF disbursement, performance under an SMP (if any), or under any other Fund-supported program.

23. Several Executive Directors have questioned whether the access levels available under the Fund's emergency credit facilities (the RCF and the Rapid Financing Instrument (RFI), a GRA instrument) are sufficient to meet the specific needs of smaller states. Current access levels may be well-calibrated to the needs of larger countries, where most disasters have an aggregate cost that is modest relative to GDP and other economic metrics. However, for small countries, the scale of natural disasters relative to economic activity can be an order of magnitude larger. This issue is taken up in a forthcoming Board paper—"*Small States' Resilience to Natural Disasters and Climate Change: Role for the IMF*"—that examines how Fund engagement with member countries particularly vulnerable to severe natural disasters can be strengthened.

CONCLUSIONS

24. Staff considers that a change in the Fund architecture for concessional lending to LICs is, at present, not warranted. The discussion above has made clear that there are areas where clarification of current guidance on implementation of existing policies can be improved. This task can be largely achieved through strengthening segments of the LIC Handbook and staff expects to complete it speedily. This paper also concludes that: (i) at this juncture, there is not a case for establishing new concessional precautionary facilities targeted specifically at PRGT-eligible members; (ii) the current safeguards on RCF use are adequate to contain risks of moral hazard and facilities shopping; and (iii) staff will more systematically promote the use of the SMP to build a track record towards a UCT-quality program instead of ad hoc informal monitoring set in an RCF request. A comprehensive review of PRGT resources and facilities is to be undertaken in 2018, in accordance with the normal five-year cycle for such reviews.

ISSUES FOR DISCUSSION

25. Do Directors agree that, at this juncture, there is not a case for establishing new concessional precautionary facilities targeted specifically at PRGT-eligible members?

26. Do Directors agree that the current safeguards on RCF use are adequate to contain risks of moral hazard and facilities shopping?

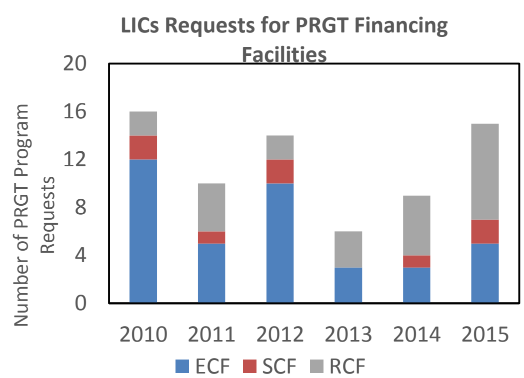
27. Do Directors agree that staff should more systematically promote the use of the SMP to build a track record towards a UCT-quality program, instead of ad hoc informal monitoring set in an RCF request?

Box 3. Use of RCF

Since its introduction in 2010, the RCF has been used frequently by PRGT-eligible member countries. So far, experience suggests that it has been used in line with its intended purposes; in particular, existing safeguards appear adequate to prevent repeated use of the RCF as a substitute for a UCT-quality arrangement.

The RCF provides rapid concessional financing to PRGT-eligible members facing an urgent balance of payments need. Assistance is provided through a single disbursement; there are no ensuing disbursements subject to ex post conditionality, although approval of the RCF disbursement may be linked to implementation of prior actions. Repeated use is allowed under certain circumstances, subject to a cumulative limit on credit disbursed under the facility (Appendix Table 1).

The scope for repeated use raises the possibility that a member would opt to make repeated use of the RCF instead of seeking financial support through an arrangement supported under the ECF or SCF. Safeguards are in place to prevent such an outcome: these include both ceilings on access under the RCF and specific limitations on repeated use. The latter restrict a member to no more than two RCF disbursements in any 12-month period. Also, to help ensure that the RCF does not support continued weak policies or create moral hazard, the Board will not approve an additional RCF disbursement for a member that has received a disbursement during the preceding three years unless (i) the BOP need was caused primarily by a sudden, exogenous shock ("shocks window"); or (ii) the member has established a track record of adequate macroeconomic policies in the six months preceding the request. Moreover, the RCF can only be used if it is not feasible or necessary to implement a Fund-supported program with a UCT-conditionality standard.



Since its introduction in 2010, the RCF has been used frequently. Financial support under the RCF has been approved on 24 occasions, representing one-third of all requests for support from the PRGT during this period and over one-half in the past two years (2014–15). The 24 requests came from 16 members, including nine states in a fragile situation and five small states. The RCF has two windows that, so far, have been used about equally. The "shocks window" is for members with urgent balance of payments needs from exogenous shocks, either economic (such as terms of trade) or non-economic (such as natural disasters), that are sudden and not related to the member's policies. Thirteen such requests have been made—nine in the wake of natural disasters, three linked to the Ebola outbreak, and one due to the global economic crisis. The "normal window" is for all other cases: eleven requests for access have been approved, primarily from countries in fragile/post-conflict situations.

All the RCF requests not based on exogenous shocks included a quantitative monitoring framework. The quantitative monitoring frameworks covered a period of at least three months; half of the disbursement requests had prior actions, ranging from one to three per request. In addition, of the seven members who requested RCFs to meet urgent balance of payment needs while also establishing a track record, all but one have transitioned to an ECF arrangement within a year after the RCF request.

Experience suggests that repeated use of the RCF has *not* been to avoid a program with ex post conditionality. Six members have used the RCF more than once (two small states, four fragile states). Three members have requested two RCF disbursements from the "shocks window," of which only one made two requests within a 12-month period. The other three members made multiple requests to meet urgent balance of payment needs while also building a track record to facilitate a UCT-quality arrangement (one had three requests and the others two each). All three of these requests had a quantitative monitoring framework as part of the policies underlying the requests: the monitoring framework employed a parallel SMP in one case, a more informal framework set out by country authorities in a Letter of Intent in the other cases.

Appendix Table 1. Summary of Norms, Limits, and Procedural Safeguards

	Access Limits 1/
Cumulative access limits	
All PRGT facilities	
Normal	225
Exceptional	300
RCF	
Normal 2/	75
Exogenous shocks window /2	75
RFI	75
Annual access limits	
All PRGT-facilities	
Normal	75
Exceptional	100
SCF (precautionary)	
Average annual	37.5
At approval	56.25
RCF	
Normal 2/	18.75
Exogenous shocks window /2	37.5
RFI	37.5
Norms 3/	
3-year ECF 4/	
High access	90
Low access	56.25
18-month SCF 5/	
High access	90
Low access	56.25
Blending proportions (PRGT:GRA) for members presumed to blend 6/	1:2 with concessional access capped at the applicable norm (all GRA thereafter)
Procedural safeguards	
New DSA 7/	
Total access in any 24-month period	60
Informal Board Meeting in advance of new PRGT request /8	
Total access in any 36-month period	135

1/ The new access limits in effect January 26, 2016 do not affect disbursements under arrangements approved prior to that date and any changes in access levels is to be justified by balance of payments needs in accordance with the standard policies for augmentation of access amounts. Outstanding PRGT credit in existence as of January 26, 2016 counts towards the current annual and cumulative PRGT access limits.
2/ Any RFI access also counts towards these limits.
3/ High access norms apply if PRGT credit outstanding is less than 75 percent of quota. Norms are not applicable if PRGT credit outstanding >150 percent of quota.
4/ For four-year ECF arrangements, access for the fourth year is expected to be set in line with the average annual access corresponding to the norm that would otherwise have applied to a successor three-year ECF arrangement. For countries whose outstanding PRGT access is above 150 percent of quota, the norms do not apply.
5/ For SCF arrangements of any other length, the norms will be proportionately adjusted to keep annualized average access unchanged.
6/ For the RCF, which has no norm, the cap on access to concessional resources is the annual limit, while for the SCF treated as precautionary this cap applies to the average annual access limit.
7/ A new DSA is also required for any PRGT financing request if it involves exceptional access to concessional resources or involves a member country with a high risk of debt distress or in debt distress.
8/ An early informal Board meeting is also required if the financial request would involve exceptional access to concessional financing.

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