

**SIMPLIFICATION OF IMF LENDING.
WHY NOT JUST ONE FLEXIBLE
CREDIT FACILITY?**

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Simplicity is the ultimate sophistication

Leonardo Da Vinci

La falta de sencillez lo estropea todo (A lack of simplicity ruins it all)

Miguel de Unamuno

Abstract

This paper proposes updating and improving the IMF's lending mechanism, by replacing all of its credit lines with a single financial facility. Under this single facility, costs would rise with the volume drawn down and the time elapsed. At the same time, arrangement and repayment periods would be more flexible. The result would be a less complicated financing mechanism, more readily adaptable to borrowers' needs, stronger incentives to avoid excessive use of IMF resources and equitable treatment for all member countries.

JEL Classification: F33, F34, F5.

Keywords: credit lines, crisis resolution, financial facilities, IMF, official lending.

1 Introduction

The International Monetary Fund (IMF) is currently conducting an ambitious strategic review, with the aim of achieving self-renewal and greater efficiency in its activities in the medium term. The reasons for the launching of this process are numerous. On one hand, the IMF has been criticised over the continued existence of anachronistic mechanisms and systems that need updating. For example, a sizeable section of its membership, principally emerging market economies and low-income countries, consider their representation on the institution's governing bodies insufficient. On the other hand, the IMF must adapt to a situation of the international financial system that is very different from the one in which it has operated in recent decades, with lending currently at all-time lows. This circumstance has two immediate consequences. The first is an increase in the specific weight of surveillance tasks, in the absence of demand for financing. The second is strangulation of the IMF's income statement, as its revenues have depended almost entirely on receipts of interest on its lending. This latter consequence has obliged the IMF to reduce its spending and to seek new sources of financing.

In line with the foregoing, this review has largely focused on the improvement of member representation mechanisms, the update of surveillance tasks, the redefinition of the IMF's role in low income countries, and, as referred to above, reconsideration of its finances. As a result, little attention has been paid to the IMF's role in the emerging economies and in crisis resolution. However, in view of the recurring cycles of crisis emergence in the past, the decline in IMF lending should not be taken to mean that the IMF's role as a lender is no longer necessary. In fact, there is a strong need for the IMF's role in the emerging economies, which is normally linked to the granting of loans, to be reviewed, especially given the current emergence of alternative financing mechanisms. The strategic review and the recent decline in levels of lending are an ideal situation in which to critically examine the IMF's loan granting mechanisms and to incorporate such improvements as may be considered opportune.

That is the aim of this paper. As will be seen below, the IMF's lending mechanism has, over the course of time and with the emergence of new types of financial crisis, turned into a complex catalogue of facilities, with a structure of incentives and periods that could be improved. The purpose of this paper is precisely to re-balance these aspects by replacing the current range of financial instruments with a single facility. This facility would be more flexible than the present ones and would have a strong system of incentives to ensure that loans are adapted as far as possible to borrowers' needs, thereby minimising excessively lengthy and voluminous use of resources. The advantages of an approach of this type are numerous: a single facility would i) reduce the complexity of the IMF's lending mechanism, without reducing its effectiveness; ii) enhance its capacity to adapt to different needs and unforeseen situations; iii) tend to stimulate the prompt adoption of reforms by countries in difficulty; iv) boost the turnover of IMF resources so as to increase their availability; v) tackle the problems arising from the prolonged use of resources; vi) limit the IMF's financial exposure to strictly necessary levels; vii) provide uniformity of treatment for all member countries; viii) reduce the risk of discretionality in the allocation of facilities, and ix) promote greater involvement by the country in the initial phase of negotiation of the arrangement and in any subsequent modification.

The starting point for the development of this proposal is an IMF with the following distinguishing features: i) the IMF is, in essence, a credit cooperative with practically universal participation and, therefore, it is the countries themselves that lend to each other, so that the institution's interests are those of its members; ii) the IMF's nature as a public good extends to all its activities and functions, since all its objectives are also of this nature;¹ iii) the IMF's lending activity is basically targeted at short-term balance of payments needs; iv) collaboration between the IMF and the World Bank must be very close, while their tasks must be well defined to avoid any overlap, and v) the Fund may and should function as a *Lender of Final Resort* (LoFR) not as a *Lender of Last Resort* (LoLR), the main distinction being the fact that a LoLR lends unlimited amounts at penalty rates, while a LoFR lends limited amounts at a subsidised rate and in exchange requires compliance with certain conditions.²

This paper is organised into five sections. First the IMF's current lending framework and how it has developed over time is analysed. Then, use of the various facilities over the last 17 years is studied and the relevant stylised facts distilled. Subsequently the theoretical proposal for a single facility is detailed and the way it works is compared with the current credit provision mechanisms. Finally, the effect (mainly in terms of cost) that application of this scheme would have had in four selected real cases is analysed. The paper ends by setting out the main conclusions.

1. See the Articles of Agreement of the IMF, Article I – Purposes.

2. See Mussa (2005).

2 The IMF's current lending framework

A member country can apply for IMF assistance³ if it has a balance of payments need, i.e. if it is unable to obtain sufficient market financing, on accessible terms, to meet its international payments. Thus, IMF lending constitutes a bridge that enables members in difficulty to rebuild their international reserves, stabilise their currency, continue to make their import payments and restore a favourable climate for economic growth, while providing them with a greater degree of flexibility to apply adjustment policies and reforms to correct their external imbalance.

IMF financial assistance is accessed via three channels, the common purpose of which is to transfer currency reserves to member countries; regular operations, Special Drawing Right (SDR) allocations and concessional operations. Regular operations are financed with funds from the General Resources Account (GRA), the basic element of the IMF's financial structure, consisting of members' contributions in the form of quotas. In the case of SDR allocations, the IMF issues and distributes among its members international reserve assets, which countries may use to obtain foreign currency from other members. Concessional operations (ESF/PRGF loans) are used by the IMF to lend long-term to low income countries, at a subsidised fixed rate of interest. This paper focuses solely on regular lending transactions, which represent the bulk of the IMF's lending activity.

This ordinary credit is not in the form of conventional loans, but is instead extended through a mechanism of currency purchases and repurchases, which works similarly at the functional level. When the IMF grants financing to a country, the latter purchases SDRs or some other "strong" currency from the IMF, in exchange for the equivalent amount of its own currency. Subsequently, to repay this financing, the country repurchases its own currency using SDRs or some other strong currency. It should be noted that, strictly speaking, credit only exists when the member country's purchases exceed the whole of its quota since, until then, it is merely making use of its contribution to the co-operative.

The credit granting process is based on an arrangement which stipulates, on one hand, the specific policies and measures that the country undertakes to implement to resolve its balance of payments problem and, on the other hand, the amounts that the IMF shall make available to the member through one of the facilities detailed below. The IMF will previously have assessed the situation of the borrower country and determined whether recourse to its funds is justified and whether the guarantees securing these funds are sufficient. The IMF also estimates the borrower's financing needs and the volume of debt and maturities it is able to assume, without the debt profile becoming unsustainable, taking into account the proportion of such needs that may be covered by reasonable internal adjustment and private-sector involvement. The country, in turn, negotiates with the IMF the economic program that is to form the basis of the arrangement and presents it in a Letter of Intent to the Executive Board of this institution. When the latter has approved the arrangement, the credit is made available in the form of periodic disbursements conditional upon implementation of the successive phases of the program or, in IMF terminology, as and when the *conditionality* is complied with.

3. See the Articles of Agreement of the IMF, Articles I and V.

The IMF has a number of credit instruments, known as financial facilities or credit lines, to meet the various financial needs of its members. Ordinary loans are extended through four main facilities: Stand-by Arrangements (SBAs), the Extended Fund Facility (EFF), the Supplemental Reserve Facility (SRF) and the Compensatory Financing Facility (CFF). The IMF also provides Emergency Assistance to support the recovery of countries following a natural disaster or armed conflict, in some cases at subsidised interest rates.

SBAs are designed to help countries to address short-term balance of payments problems and, as we shall see below, channel most of the funds lent by the IMF. This type of arrangement involves a “decision of the Fund whereby a member is assured that it will be able to make purchases from the GRA in accordance with the terms of the decision during a specified period and up to a specified amount.”⁴

EFF arrangements basically work in the same way as SBAs, but their objective is to help to address longer-term balance of payments needs requiring reforms of a more structural nature. In principle, the countries for which this facility would be most suitable are those that have exceeded the specific economic level of concessional credit or, as in the past decade, economies in transition that lack sufficient access to international capital markets.

The *SRF* line is used to extend financing to countries suffering exceptional balance of payments difficulties, specifically those needing short-term financing on a large scale, as a result of a sudden and disruptive loss of confidence in the markets. Access to the SRF is not subject to the ordinary access limits, although it is subject to the *exceptional access framework* (defined below), and depends on the member country’s financing needs, its repayment capacity, the soundness of its program and its economic and financial record.

The *CFF* is an instrument to assist countries experiencing either a sudden shortfall in export earnings or an increase in the cost of cereal imports, as a result of fluctuating world commodity prices. The reason for the application for this facility must be short-term and beyond the member country’s control.

The IMF supplies *emergency assistance* (EAF) to countries that have suffered a natural disaster or are emerging from an armed conflict. A special feature of this facility is that it is not backed by conditionality, but by economic policy advice and technical assistance. In the case of help following an armed conflict there is an implicit presumption that the country will subsequently apply for an *EFF* facility or a concessional (PRGF) loan, depending on the terms thereof and its borrowing capacity.

Thus, as described above, there is in theory a specific facility corresponding to each type of balance of payments need. However, in practice, the granting of facilities has not faithfully followed such correspondence.

Table 1 shows the main features of these five facilities. The volume of financing that a country can obtain (its *access limit*) varies according to the type of loan and is determined in terms of the country’s quota in the <http://www.imf.org/external/np/exr/facts/spa/quotass.htm>

4. See the Articles of Agreement of the IMF, Article XXX (b).

IMF. When the borrower has large-scale financing needs, as in the case of a capital account crisis, the loans may exceed these limits in certain circumstances (see Section 4.2.2).

All facilities are subject to what is known as the *rate of charge (rc)*, which is made up of: i) the SDR interest rate, which is a market rate calculated on a weekly basis as the weighted average of the short-term money-market rates of the currencies that make up the SDR valuation basket (US dollar, euro, yen and pound sterling) and ii) corrections made to obtain a profit margin and accumulate certain reserves through the burden sharing mechanism.⁵ In addition to the rc, the IMF charges certain premiums or *surcharges*, based on the volume drawn down or the time elapsed, depending on the type of facility.

As Table 1 shows, on paper three facilities (SBA, EFF and CFF) have a volume surcharge and only one (SRF) has a cost that increases with the duration of the program. However, in practice, the SRF penalises duration⁶ only marginally. A 300 bp charge is imposed from the very moment the line is granted, which shows that the reason for this surcharge is not duration, but rather the large volume of credit associated with it. In other words, it is really the fact that a large volume is drawn down in a short space of time (frontloading), and not the duration of the program, that the Fund is penalising under the SRF. Moreover, the rise in the surcharge over time, at a fixed rate of 50 bp every six months, is hardly progressive, which reinforces the argument that the penalisation of time under the SRF is to some extent relative.

As for periods, the IMF distinguishes two basic ones in its programs: the *arrangement period*, during which the country can make purchases up to the total amount granted, and the *repayment period*, i.e. the time within which the loan shall be fully repaid. Each line has its periods defined and these vary within a range according to the circumstances of each borrower. In addition, as a mechanism to discourage an unnecessarily prolonged use of its resources, the IMF introduced the distinction between compulsory and expected repayment periods. Basically, this means that the debtor country must repay its loan within the expected period but, if it is not in a position to do so, it may apply to the Board for an extension up to the compulsory period.

Main features of the GRA facilities

Table 1

Facility	Access limits (% quota)	Surcharges ¹ (basis points)	Periods (months) ³		
			Arrangement	Repayment Expectation	Obligation
SBA	100% annual 300% total	100 if 200%Q < V < 300%Q 200 if V > 300%Q	12-18 (max. 36)	27-48	39-60
EFF	100% annual 300% total	100 if 200%Q < V < 300%Q 200 if V > 300%Q	36 (max. 48)	54-84	54-120
SRF	No limits ²	300 the first year 50 extra each 6m, max. 500	max. 12	24-30	27-36
CFF	10-55%	100 if 200%Q < V < 300%Q 200 if V > 300%Q	--	27-48	39-60
EAF	25-50%	--	--	--	39-60

¹ Q: quota; V: volume drawn down.
² Subject to compliance with the exceptional access framework criteria.
³ Arrangement: period during which the borrower country may apply for disbursements. Repayment: period for repaying the loan, beginning at the end of the arrangement period.
Memorandum item: commitment fee of 50 bp.

5. This mechanism is a system for splitting the financial cost arising from late repayment of credit between all the members of the institution, with creditors and debtors bearing equal proportions.

6. From now on duration refers to a length of time and not to the financial term used for the weighted average maturity of an asset's cash flows or of any series of linked cash flows.

In addition to these credit lines, the framework for the IMF's lending activity consists of *policies* or rules that are applied in conjunction with them. These policies establish how access to financing may be obtained in particular circumstances, the main ones being the exceptional access framework and the *Lending into Arrears* (LiA) policy. The former determines the conditions that a country must fulfil to be able to gain access to larger volumes of credit than those detailed in Table 1, while the latter stipulates the circumstances that must pertain and the measures that a country must take to have access to IMF lending when it is in arrears to its private creditors. These policies are outlined in greater detail below and their relationship with the single facility proposed in Section 4 is analysed.

This multiplicity of credit lines and financing terms is not the result of systematic planning by the IMF, but of past events (see Box 1). The IMF has attempted to adapt to crises and balance of payments needs, with highly diverse causes, durations and features, by creating new facilities. This has led to a proliferation of instruments that is probably excessive, since many of them have been used only temporarily while others have never been used at all. Moreover, this multiplicity of lines creates the added difficulty of deciding a priori which one best responds to a country's needs. The IMF's response has been to eliminate the most obsolete instruments in successive reviews, but there remains work to be done.

In the early years of the IMF, the use of its resources took the form of drawdowns on quotas, divided up into tranches. SBAs were not introduced until 1952. Initially conceived for precautionary purposes, their use soon spread to cover immediate financial needs.

In the 1960s the Fund introduced two new financing facilities: the Compensatory Financing Facility (CFF, 1963), originally designed to offset the adverse effects of a decline in export earnings, and the Buffer Stock Financing Facility (BSFF), established in 1969 to finance members contributions to international commodity price stabilization agreements.

The 1970s saw several new facilities established. In response to the oil crisis, the Oil Facility (OF) —of which there were two brief consecutive versions (1974 and 1976)— was set up. The Extended Fund Facility (EFF) came into being in 1974 to finance members' medium-term external imbalances brought on by structural economic changes, while the Supplementary Financing Facility (SFF), instituted in 1977 and financed with official resources borrowed outside the Fund, provided additional funds for the SBA and EFF arrangements in force.

In the second half of the 1980s the IMF introduced concessional loans for low-income countries and, within the General Resources Account (GRA), it broadened the scope of the CFF, lengthening its name to CCFF (Compensatory and Contingency Financing Facility). This facility allowed increases in the cost of oil and cereal imports to be financed and compensation for declines in export earnings due to exogenous shocks.

The 1990s witnessed a plethora of new financing facilities. With the aim of supporting countries with balance of payments problems caused by the transition from a planned to a market economy, the Systemic Transformation Facility (STF) was established, for a short period, in 1993. In the wake of the south-east Asian crisis, in 1997, the IMF launched the Supplemental Reserve Facility (SRF) to help members withstand sudden losses in confidence from markets. It was used for the first time in support of Korea, supplementing an SBA. Likewise with an eye to this type of crisis, the Contingent Credit Line (CCL) was established in 1999 for countries which, despite applying appropriate policies, might be prone to financial contagion from third countries. On a lesser scale, the Fund made available to its members a facility to alleviate potential IT problems stemming from the year-2000 (Y2K) effect.

In 2000, the IMF undertook a far-reaching review of its main financing facilities in order to rationalise them. As a result, the BSFF and the contingency component of the CCFF were discontinued, the latter adopting once more the name CFF. Emergency financial assistance, to alleviate the effects of a natural disaster or the aftermath of an armed conflict, was unified under Emergency Assistance, and it became possible to subsidise the interest rate on this facility for low-income countries (2001 and 2005). The IMF decided in 2003 to discontinue the CCL, which was never applied for by countries in a position to do so. The Fund is currently studying the case for an alternative facility to the CCL with insurance purposes.

3 Stylised Facts on the use of credit

Having described the current IMF lending apparatus, this section analyses the use that has been made of the facilities of which it is composed, in order to see if there are arguments to justify a reduction in the number of available facilities and to draw lessons for the design of a possible single facility. The database used to carry out this analysis includes all the programs approved by the IMF between 1990 y 2006.⁷ The sample consists of 290 programs, granted to 90 countries over 17 years. This period includes the most recent phase of IMF lending, which is the most relevant for the purposes of this study. Program targets in this period ranged from short and medium-term disequilibria originating in the current account (the traditional activity of the Fund since its foundation at Bretton Woods) to the so-called 21st century crises⁸ (Mexico 95, south-east Asia 97, Russia and Brazil 98, Turkey and Argentina 01 and Uruguay 02), and also included the granting of financing to economies in transition from a planned to a market model, in the first half of the 1990s.

This database only takes into account the use of currently available facilities, i.e. it does not consider those that were used during the reference period and subsequently eliminated. Their inclusion in the analysis would have strengthened the argument that the number of facilities is excessive relative to their actual use, but it has been considered more rigorous to take the currently existing instruments as the starting point.

Use of facilities, in terms of numbers

Chart 1

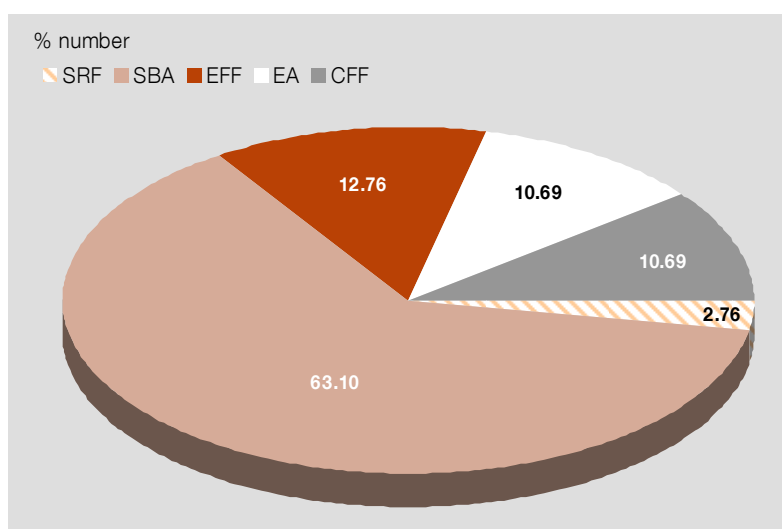


Chart 1 shows the distribution, by number, of the loans granted by the Fund. The first conclusion to be drawn is the predominance of SBA arrangements, which account for 63.1% of all the facilities granted. Also striking is the fact that SBAs and EFFs together account for more than 75% of the total. More revealing still is the analysis of the volumes of these loans, which is shown in Chart 2. The left-hand panel shows the distribution by

⁷ The analysis does not include concessional IMF lending.

⁸ See Camdessus (1995).

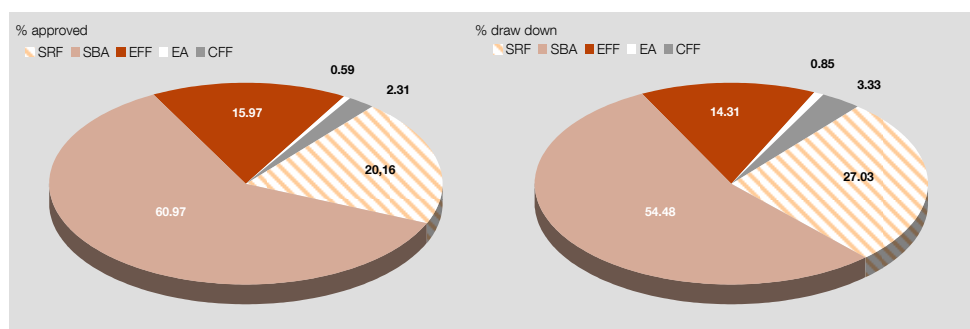
approved volumes, which gives an idea of the maximum financing that the IMF was prepared to grant following the negotiation of the programs with the borrower countries. The right-hand panel focuses on the volumes actually drawn down, which could be interpreted as the amounts that the countries really needed to cover their financing shortfalls after exhausting other channels: internal adjustment, recourse to markets and private-sector involvement.

The main difference from Chart 1 is that it reveals the true weight of the SRF since its creation in 1997 and the residual importance of the EAF and CFF facilities. Also, comparison of Charts 1 and 2 shows the great intensity, in volume terms, of the use of the SRF, i.e. the large amounts drawn down under this facility (more than one quarter of the total volume drawn down) in a very small number of programs (8 out of 290).

The distribution by facility of the volume of financing drawn down also shows that practically all the institution's lending (97.2%) is concentrated in three lines: SBA, EFF y SRF. This high degree of concentration, the great similarity between the SBA, EFF, CFF and EAF (especially the first two, which only differ as to their periods and type of conditionality)⁹ and the fact that the SRF is always granted in conjunction with another facility (normally an SBA or, very rarely, an EFF) suggest that there is perhaps an unnecessarily large variety of facilities and that it would be possible to reduce their number. All this also goes to justify the exclusive focus of the comparative analysis of the following section on the three largest facilities.

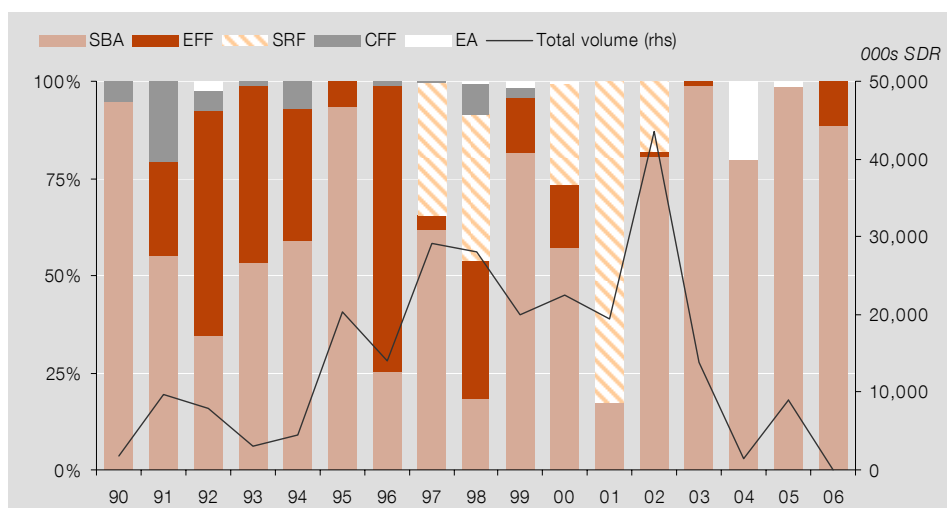
Use of facilities, in volume terms

Chart 2



Analysis of approved lending volumes over time (see Chart 3) shows that the aforementioned concentration of credit remained constant throughout the period of study, with a marked preponderance of use of the SBA. In broad terms, granting of the SBA was accompanied in an initial phase (1991-1998) by use of the EFF and afterwards (1997-2002) by that of the SRF. Four years constitute the exception that proves this rule: the volumes of credit approved under the EFF in the resolution of crises in Argentina (1992) and Russia (1996) exceeded the amounts of lending under the SBA; in 1998, the support given by the Fund to Argentina, Indonesia and Ukraine through the EFF was combined with the assistance granted to Russia and Brazil through the SRF; this latter facility played a key role in 2001 in the context of the Argentine and Brazilian crises.

9. As already indicated, with a more structural content in the case of the EFF.



It can also be seen from the distribution over time that the use of the SRF was concentrated in a six-year period, from its creation until 2002, when the crises for which it was designed proliferated. Over the last four and a half years there has not been a single application for this facility. Also, the EFF was used most intensively in the first half of the 1990s, with continued use since, but at a much lower rate. Finally, it should be noted, almost at the anecdotal level, that the apparent revitalisation of the EAF in 2004, actually corresponds to the aid package granted to Iraq.

Table 2 shows the average use of the current facilities, both in terms of volume and duration. According to this table, the pattern of use of the SRF is characterised by access to around 300% of the quota and a duration of less than one year. For its part, the standard SBA involves access to slightly over 70% of the quota and a duration of almost a year and a half, while the standard drawdown of the EFF is nearly 90% of the quota, with an average actual duration of close to three years. It is important to note that the data for approved and drawn down volumes in this table, unlike in Chart 3, do not take into account arrangements under which no purchases were made (precautionary SBA and EFF programs). Their inclusion would have reduced the ratio of drawn down to approved volumes and, in consequence, distorted the picture of the real use of these two lines.

Average use of IMF credit

Table 2

	Volume (% quota)		Duration (months)	
	Approved	Drawn down	Planned	Actual
SBA	111.66	71.70	16.19	17.10
EFF	132.20	87.49	35.59	33.95
SRF	303.02	292.14	10.25	9.88
CFF*	27.81	27.81	--	na
EAF*	20.97	20.97	--	na

*These facilities have no arrangement period, as shown in Table 1.

Use of IMF credit by quota tranches

Chart 4

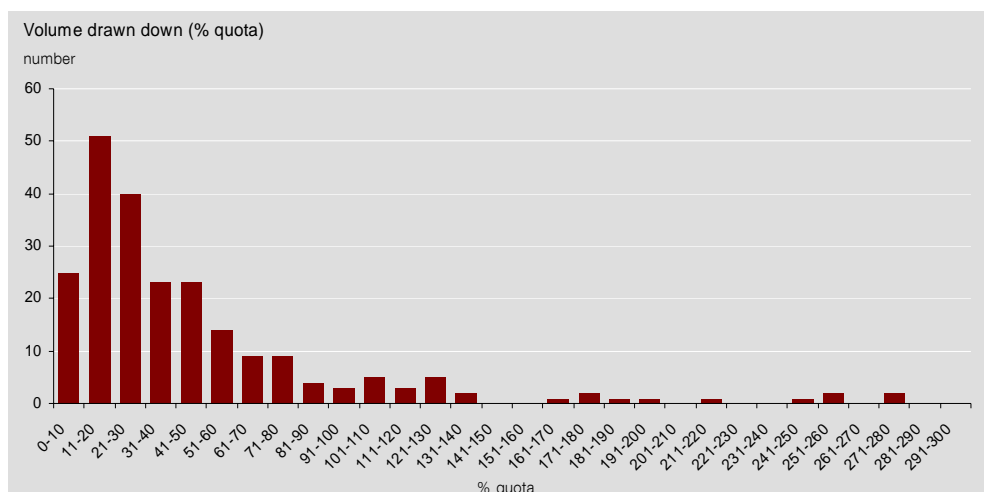


Chart 4 shows the distribution of IMF credit by tranches of volume of actual access, expressed as a percentage of quota. For the sake of clarity, the analysis stops at 300%, which is the upper limit to ordinary access. The credits granted below this threshold account for more than 96% of the facilities approved during the period of study. Only ten cases are excluded which, albeit significant in terms of their volume and the media and academic attention they have attracted, are of little relevance to this analysis. The highest frequencies may be seen to be concentrated around the lowest quota tranches (more than 82% of programs had access to below 80% of quota) reflecting the IMF's traditional lending activity prior to the outbreak of the capital account crises of the 1990s.

Use of IMF credit by duration

Chart 5

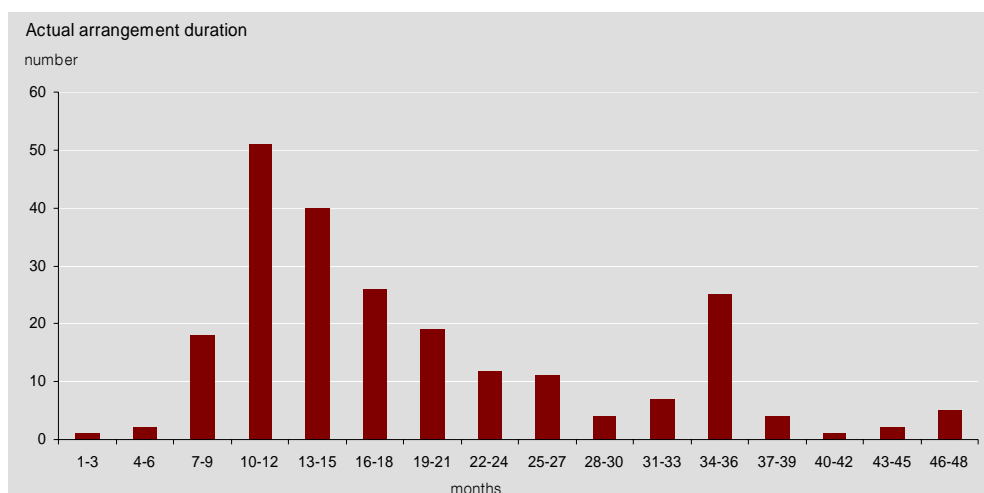


Chart 5 shows the distribution of IMF lending by time intervals (in this case all programs are included). Two periods stand out: first, 12-18 months, which corresponds to the normal life of SBA and SRF programs; second, the interval that includes 36 months, the normal term of an EFF. These two charts give an indication of suitable volume and time thresholds for the subsequent design of a single financial facility that aspires to replace all of them.

4 Proposal for a Single Financial Facility

If the IMF is to retain its current central role as lender to countries in crisis, it must have up-to-date financing mechanisms that cater for its members' needs, particularly in situations like the current one, characterised by the loss of borrowers and the emergence of new financing alternatives (mainly through self or collective insurance). Sections 2 and 3 set out some ideas to be taken into account in this respect. The IMF's lending mechanism has, over the course of time and with the emergence of new types of financial crisis, turned into a complex catalogue of facilities and financing terms. Despite this variety, the use of credit in the last few decades reveals a high and persistent concentration in a small number of facilities which, moreover, in some cases are very similar. In addition, the cost structure of IMF lending offers only partial incentives (either volume-based or time-based, but not both) to use resources in a way that minimises unnecessarily large or long loans.

All this suggests at least two general areas that could be improved. First, the IMF's catalogue of financing facilities could be simplified and made more flexible without detriment to its usefulness for members. Second, its incentive structure could be strengthened so as to better reconcile the coverage of borrowers' needs with the IMF's obligations. In accordance with this approach, the present section proposes replacing the existing credit lines with a single financial facility (SiFF)¹⁰ endowed with a more complete and uniform cost setting system.

4.1 Design

4.1.1 AIMS

In accordance with the ideas just described, the SiFF proposed below has the following aims:

- *To simplify the financing mechanism* since, as discussed above, in principle it is possible to reduce its complexity without reducing its effectiveness.
- *To enhance its flexibility and adaptability* vis-à-vis unforeseen needs and situations.
- *To strengthen the incentive structure of the mechanism*, so as to adjust as far as possible the loan volume and duration to borrowers' needs. In other words, the aim is to minimise unnecessarily long and voluminous use of IMF funds, provided that sufficient financing is made available to the country, not to speed up repayments irrespectively of the country's circumstances. This would:
 - Stimulate the prompt adoption of measures by the borrower country to correct the problems that gave rise to the financing need.
 - Promote the turnover of IMF funds and thus increase their availability to all its members.
 - Avoid the problems arising from prolonged use of funds and excessively long financial dependence on the IMF.
 - Limit the IMF's financial exposure to that which is strictly necessary, since it gives rise to greater risk when credit is concentrated in fewer members, as has been occurring in recent years.

¹⁰ This article uses the denotation SiFF to differentiate this facility from those currently in existence. In practice, there is no reason why the name SBA cannot be used for the new instrument.

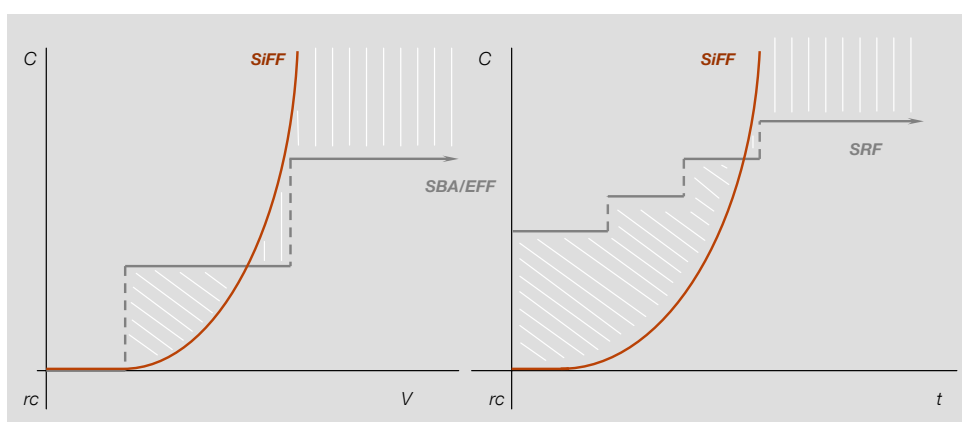
- *To provide uniform treatment to all member countries* in accordance with its cooperative nature. If there were just one credit facility, it would obviate problems of discretionality (or arbitrage) when the IMF assigns different facilities or combinations of them to countries in similar situations, with the consequent difference in financing cost.

4.1.2 COST STRUCTURE

As mentioned above, the current SBA and EFF facilities have a stepped cost profile, rising with the volume of financing granted, irrespective of the duration of the program. The opposite is true for the SRF facility, the financing cost of which rises, at least theoretically, as the duration of the program lengthens, irrespective of the amount of the financing (see Figure 1).

SiFF compared with SBA/EFF and SRF facilities

Figure 1



Combining these two criteria in a single facility, the cost of the proposed SiFF varies with the volume and the duration of the financing. The cost-setting system of the SiFF would be based on the IMF's current rate of charge¹¹ (rc), adding extra basis points (ebp) as the volume (V) —in terms of quota— and the time (t) of the financing increase. To achieve the objectives mentioned above, the SiFF would offer cheaper loans for those tranches of volume and duration considered appropriate,¹² while at the same time making financing above certain thresholds more expensive.

Figure 1 compares the SiFF with the SBA/EFF facilities (left-hand panel) and with the SRF (right-hand panel). The comparisons have to be separate because, as mentioned above, the existing facilities vary with different variables. As can be seen, the SiFF could incorporate initial tranches without surcharges, both for the initial months of the arrangement and for low volumes of access. The diagonally hatched areas represent cheaper financing with the single facility or, in other words, a greater incentive to apply to the IMF upon such terms as entail a sparing use of resources, in line with IMF's objectives. This would minimise risks for both parties and promote sustainable and well balanced borrowing across the various sources of financing. The vertically hatched areas represent a rise in the relative cost

¹¹. As defined in Section 2.

¹². These tranches would be set by the IMF Executive Board and could be revised periodically to adapt them to the current international economic conditions.

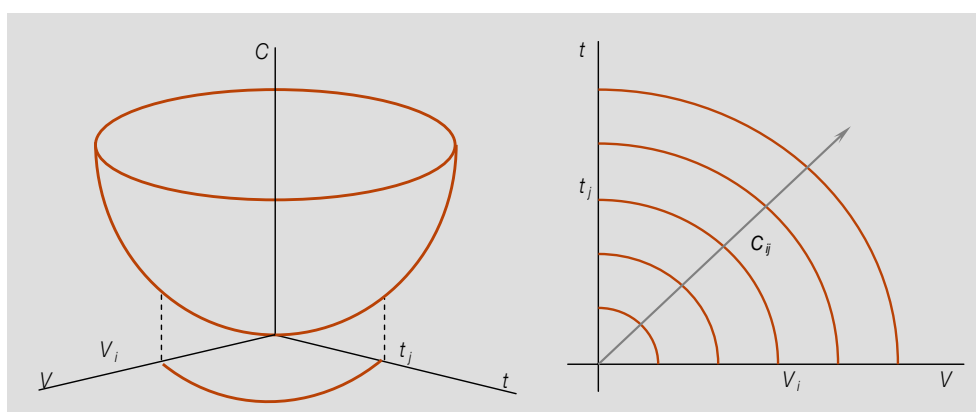
of resources or an incentive not to use IMF financing on conditions that generate risks or diverge from the functions for which the IMF is conceived.

It is important to note that the decline in costs referred to above would not in any event entail a relaxation of the requirements for access to IMF credit. First, the justification required for the granting of a loan would of course be just as necessary as at present. Second, the IMF, in its negotiations with the borrower, would continue to establish the terms of the program, in accordance with its assessment of the country's financing needs and repayment capacity. Finally, once the program were agreed and in effect, purchases would continue to be subject to compliance with the conditionality established therein.

The representation of the SiFF in three dimensions¹³ against its two independent variables gives rise to a function like the one in the left-hand panel of Figure 2. Also, the projection of this function onto the lower plane (V, t), in which the axes reflect the program volume and time variables, generates a map of indifference curves or isocosts, in which the greater the distance from the origin the higher the cost (see right-hand panel of Figure 2). This map could be helpful for the decision-taking of a country in difficulty, which would be able to explore, a priori, the cost of the different combinations of time and volume sufficient to meet its needs.

Graphic representation of the SiFF

Figure 2



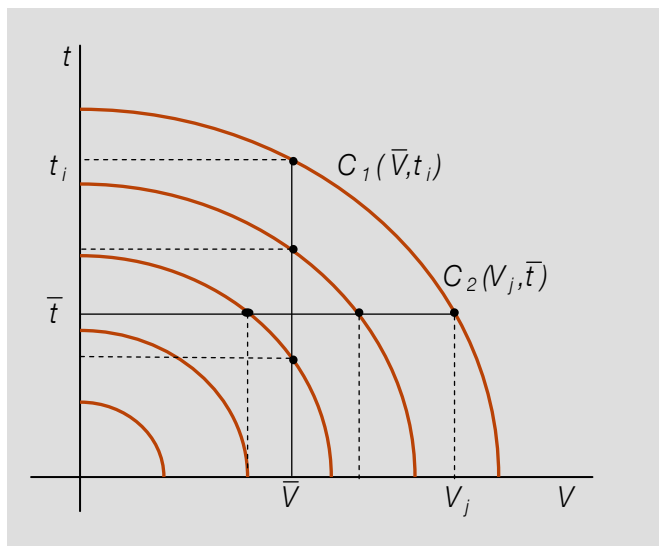
It should be pointed out that under this system the cost of a program would not be fixed, but rather would vary with the time elapsed and the volume on loan at any point in time, which would make the cost setting mechanism for IMF financing more sophisticated. Nor would programs of the same type necessarily give rise to the same cost. For example, in the case of an arrangement to tackle a current account crisis, once the financing gap to be covered (V) has been determined, the country could make estimates of the cost of the arrangement, based on how much time is considered necessary to correct the external imbalance (t_i). Similarly, in the resolution of a capital account crisis in which the time variable (t) is fundamental and known (normally a very short period), but the capital requirements are more uncertain, the country can get an idea of how the program cost will rise with the volume of financing needed to restore the confidence of the international markets (V_i).

¹³ For the sake of clarity, the function is assumed to be continuous and symmetric, i.e. costs grow equally in proportion to volume and time.

The above cases illustrate different types of program in which most of the uncertainty lies in the duration or the volume of the program, respectively. The same financing cost does not necessarily imply the same type of program. Indeed, different combinations of volumes and times on the same isocost curve may correspond to programs with very different aims and contents. This is the case represented by points C_1 and C_2 in Figure 3, which illustrate different combinations of V and t to address imbalances of differing natures, but which result in the same cost.

Different cost scenarios under a SiFF

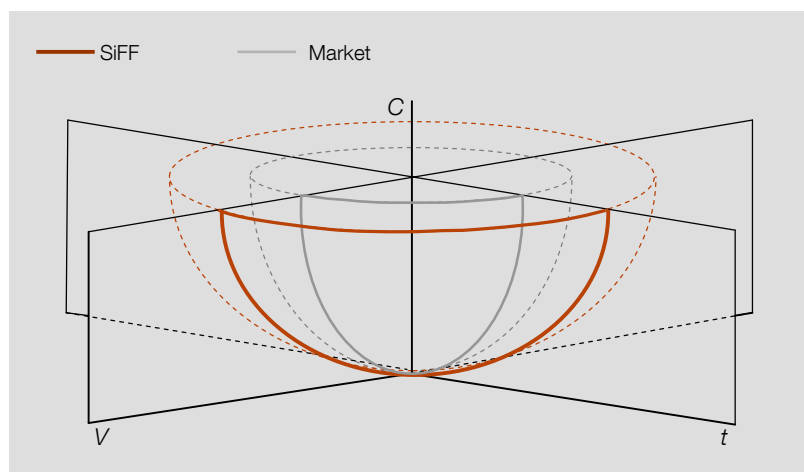
Figure 3



Returning to the three-dimensional representation of the SiFF, the terms on which the Executive Board considers it appropriate to provide financing would be reflected graphically in the degree of openness of the cup or corolla. More stringent conditions, i.e. more expensive financing, would give rise to a more vertical cup and vice versa. Likewise, market financing conditions can be represented by another corolla (see Figure 4). In crisis situations, the latter would always be contained by the cup of IMF financing since, given its public good nature and cooperative purpose, the IMF will always offer easier terms than the market.

Financing terms

Figure 4



4.1.3 PERIODS

Unlike the current arrangement periods, which are preestablished for each facility, the arrangement period of the proposed single facility could be determined on the basis of the conditionality associated with each program. This option would increase flexibility and make for facilities better adapted to the particular needs of each case.

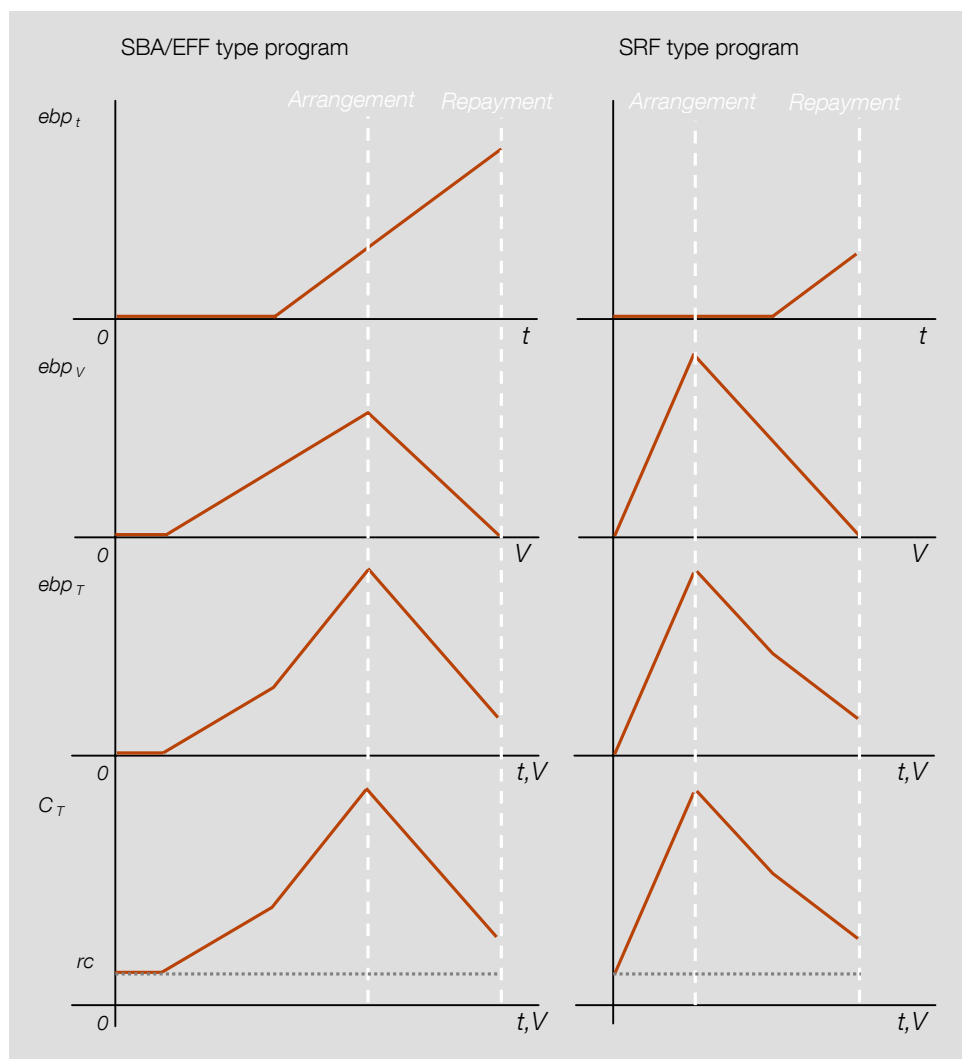
Likewise, the repayment period could be set by the IMF in each case, in accordance with the borrower's needs and debt sustainability profile. The establishment of an ad hoc repayment period would not preclude the SiFF's time-based surcharge component, since the latter would always act as the main incentive to minimize an excessively lengthy use of the resources.

As for the sequence of repayments, an orientative schedule of repurchases could be established to avoid excessive market reaction in the event of failure. Such cases would not constitute default, although the borrower would be required to justify the delay. This option would have a number of advantages, as it would i) facilitate the IMF's forecasts of liquidity and resource rotation, ii) provide a date to which expectations (both of the country and the markets) regarding the completion of the program could be anchored, iii) permit those programs with accumulated arrears to be identified, and iv) provide an additional incentive, along with those already incorporated in the SiFF (via costs) and other elements of the lending framework (conditionality, preferred creditor status, etc.), for the appropriate use of the Fund's resources. It would not be necessary to maintain the distinction between expected and compulsory periods, since the combination of the orientative schedule and rising costs over time would be sufficient to avoid unnecessary delays in the repurchases. Eliminating this distinction, which is not always well understood by markets, would help to simplify the current lending mechanism.

4.1.4 COST PROFILE

Figure 5 illustrates two examples of how the cost of the single facility would evolve over time when used to replace an SBA or EFF arrangement (left-hand panel) or, alternatively, an SRF (right-hand panel). In both cases, the total cost of the facility (C_T) would be obtained by adding to the rate of charge (rc) the surcharges that rise with the duration of the program (ebp_t) and those that increase with the volume drawn down (ebp_v). This incremental character of the cost is what would strengthen the incentive structure leading to a prompter as possible repayment which, in turn, would require the country to adopt corrective measures to get the economy into shape. This measures may be undertaken both within the arrangement period (required or not by conditionality) and along the repayment period, during which, even in the absence of conditionality, the country would be interested in improving its situation.

For the sake of simplicity, the analysis considers a linear evolution of the use of credit, and therefore of the cost associated therewith, rather than step draw-downs, as occur with the current facilities and as would apply under the SiFF. The arrangement and repayment periods are marked on the x-axis which represents volume and time.



In the left-hand panel (SBA or EFF), after the time- and volume-based exemptions in which surcharges are not imposed, C_T grows in line with the time elapsed and the volume drawn down, until the arrangement period ends, when the country can no longer make further purchases and, in principle, begins repayment. From that point, C_T diminishes, although not as sharply as the surcharge on drawdown volume (ebp_v), owing to the effect of the increase in the cost associated with the passage of time (ebp_t). As already explained, this cost associated with the total time elapsed is the distinguishing feature of a single facility with respect to an SBA or EFF arrangement and is the main additional incentive for early repayment.

Unlike in the foregoing situation, when the SiFF replaces an SRF (right-hand panel), C_T increases in proportion to ebp_v as a result of the frontloading nature of this type of loan. Once market confidence has been restored and the foreseeable repayment period has therefore commenced, C_T diminishes, although less sharply than ebp_v , again due to the effect of ebp_t , provided that not all the program falls within the time-based exemption period, which would be reasonably likely in short programs. The distinctive feature of the single facility with respect to a conventional SRF is the additional cost it introduces for the use of a

large volume of financing, and the recognition that this additional cost is in fact due solely to the high volume drawn down and not to the time elapsed.

4.1.5 EVENTUALITIES

During the life of a SiFF, eventualities may arise at two different times: during the arrangement period of the program or during the repayment period. If a country's financing needs increase during the arrangement period, there are two possible courses of action. First, the IMF could grant an *increase* in the volume and/or an *extension* of the time periods available to the borrower. This option means that the country would have to bear, in addition to the ebp_v generated by the total volume of credit used, i.e. the original amount plus any increase granted, the ebp_t generated by the time elapsed from the date of the arrangement. The other option consists of terminating the arrangement under the SiFF and opening a new one with a credit volume equal to the outstanding volume of the first arrangement plus the amount drawn down under the second, but with ebp_t starting from zero, which would lower the cost of this second option.

The choice between the two options would be left to the judgement of the Executive Board. If the source of the new needs were beyond the borrower's control, the Board could opt to replace the old program with a new one, i.e. the least onerous option for the country. If, on the other hand, the unforeseen financing needs were due to non-compliance with the program, the Board might choose to increase the volume available to the country, but within the same program, with the resulting cost increase.

If the financing needs were to emerge during the loan repayment period, the foregoing options would not arise. Once the program arrangement period had ended and the program conditionality had been complied with, the Board would have to decide whether or not the granting of a new arrangement were warranted, and the country would always opt to repay the outstanding amount under the first arrangement with the funds from the second one, so as to avoid the time component of the cost. A clear and transparent communication should be observed in these cases to avoid the perception that a mere debt rescheduling is taking place.

4.2 Interaction with other elements of the IMF's lending framework

4.2.1 PREFERRED CREDITOR STATUS AND PROGRAM CONDITIONALITY

Apart from the incentives incorporated in the financial facilities, the IMF has two important lines of defence of its resources: preferred creditor status and program conditionality. The former, implicitly recognised by the international financial community, preserves the Fund from credit risk and could effectively strengthen the granting of a single financial facility.

The protection of the IMF's resources provided by conditionality is even more solid, as it is not based on a tacit multilateral agreement, but on compliance with a set of specific measures upon which the continuity of the credit is conditional. Conditionality would be included as an integral part of the functioning of the SiFF, in the same way as in the facilities available now. In support of this argument it should be noted that the structure of conditionality as specified in the current Guidelines¹⁴ does not vary according to the type of facility and that its tools (Prior Actions, Performance Criteria, Indicative Targets, Structural Benchmarks, etc.) are common to all the programs, although their presence and weight in

14. IMF (2002).

each varies according to the type of crisis to be resolved. Conditionality would, moreover, play a significant role when the length of the arrangement period of the SiFF is determined.

4.2.2 EXCEPTIONAL ACCESS FRAMEWORK

As already mentioned, the IMF does not, strictly speaking, grant credit until the country in difficulty has borrowed beyond its quota. Except in the case of SRF arrangements, currently access to the Fund's resources is subject to an annual limit of 100% and an absolute ceiling equal to three times the country's quota.¹⁵ IMF financing beyond these limits is regulated by the exceptional circumstances clause (1983) and by the exceptional access framework (2002), the latter being introduced to help the IMF promote private-sector involvement in crisis prevention and resolution.

The exceptional access framework requires four criteria to be met simultaneously: i) the member is experiencing exceptional balance of payments pressures on the capital account resulting in a need for Fund financing that cannot be met within the normal limits; ii) a rigorous and systematic analysis indicates that there is a high probability that the debt will remain sustainable; iii) the member has good prospects of regaining access to private markets such that IMF financing would constitute a bridge, and iv) the policy program of the member country provides a reasonably strong prospect of success. Despite its short life, the framework has been violated on various occasions (Argentina and Brazil are well known examples), possibly as a consequence of its excessively rigid design.

The proposed SiFF is not intended to resolve the internal problems of the current framework, but neither would it conflict with it. The SiFF, like the current facilities, could channel IMF resources beyond the normal access limits, provided that the country were to comply with the criteria mentioned or with such criteria as the IMF may decide to adopt in future, but not otherwise. The greater flexibility of the facility and its cost structure, in particular the component linked to the volumes drawn down, should not be seen as offering a blank cheque to the borrowing country. Rather, these two elements serve more effectively the Fund's role as lender.

4.2.3 PRECAUTIONARY ARRANGEMENTS

IMF financial assistance is not only granted to resolve crises, but may also be preventive. Precautionary arrangements¹⁶ are ordinary SBA and EFF arrangements in which the authorities of the country declare, normally when signing the arrangement, their commitment to implement a program supported by the Fund, with all its associated conditionality, and their non-binding intention not to make purchases during the arrangement period. The aim of this type of arrangement, like the cases in which it is used, is multifarious, although normally it is intended to cover a possible external imbalance.

In certain cases, these arrangements lose their precautionary nature and become ordinary SBA and EFF programs once the imbalance materializes and the country requests draw-downs of the amounts committed under the arrangement. In other, less frequent, cases, SBA and EFF facilities already opened in response to an actual imbalance

¹⁵ The IMF's original by-laws set the annual and cumulative access limits at 25% and 100% of the quota, respectively. The subsequent introduction of different facilities and the slow growth of the quotas in comparison with the demand for financing raised these limits, which in the 1980s reached the levels of 200% (annual) and 600% (cumulative).

¹⁶ In the period 1990-2006 precautionary SBAs represented 27% of total SBAs in terms of number of programs and 14% in terms of approved amount. In the case of precautionary EFFs, the percentages were 11% and 8%, respectively.

subsequently take on precautionary status once it is considered that the initial problems have been resolved and will not give cause for further draw-downs. The underlying motivation in these cases is mainly the country's desire to transmit to third parties the message that it has a strategy for exiting from its financial relationship with the IMF (see Section 4.2.5).

The SiFF, insofar as it is capable of replacing all the Fund's facilities, could also fulfil the precautionary role that is sometimes given to SBA and EFF facilities and thus satisfy the same objectives of coverage and, where applicable, of exit signalling, at an appropriate cost. The fact that the SiFF rationalises and simplifies the Fund's lending apparatus could also help to improve the communication of precautionary arrangements, which not always provide sufficient information or are unfamiliar to third parties (public opinion in the borrowing country, markets, other IFIs, etc.), and, therefore, could improve the level of understanding and interpretation of them.

The labelling of a single facility as precautionary would not raise substantial problems in terms of cost either. As pointed out above, the cost of ordinary SBA and EFF facilities grows with the volume of funds drawn down and, unlike in SRF arrangements, is independent of time, so the cost of using these facilities for precautionary purposes is practically zero. Similarly, the granting of a precautionary SiFF would not involve any charges as long as the country were not to request resources from the Fund. If it were to, the facility would lose its precautionary nature and would be activated with the aforementioned cost structure *from the first draw-down*.

In the same way, a SiFF set up with the same aim and features as SBA and EFF arrangements could be made precautionary at any time during the arrangement period. In line with the examination of the time behaviour of SiFF costs (left-hand panel of Figure 4), the interruption of draw-downs would freeze the costs associated with the volume drawn until the commencement of repayments, while the time-related costs would continue to grow.

4.2.4 CONTINGENT-INSURANCE LINES

Apart from the precautionary use of instruments designed for crisis resolution, the debate on crisis prevention focuses on the idea of designing and introducing specific lines for this purpose. A first attempt was the aforementioned CCL. The possibility of introducing a new facility known as the Rapid Access Line (RAL) is being considered.

Before analysing in depth the interaction that could take place between the SiFF and the RAL (or any other line of this type), it should be pointed out that the latter is strictly speaking more a policy for accessing resources in certain circumstances (in this case in the absence of crisis) than a financing facility. As conceived so far, the objective of the RAL would be to provide applicant countries with an insurance mechanism to protect them from a possible unfavourable change in financial conditions. Its most characteristic feature would be the possibility that countries with solid fundamentals would be able to obtain the right to make purchases if they were to fulfil certain prerequisites. In other words, the country would comply with ex ante conditionality in order to be able to draw down resources immediately, should it need them.

According to this initial conception, the RAL may be considered to have two dimensions. First there is the precautionary one, i.e. in the absence of the contingency. This would include the pre-qualification criteria, the system to assess compliance with such criteria and the duration of the insurance. Second there is the resolution dimension, which

would come into play if and when the contingency occurred. In this respect, the design of the RAL envisages the definition of the applicable financial conditions and the level of access to resources. All the features included in this second group, which are in principle very similar to the terms of the current SRF, would be fully covered by a SiFF. The features of the precautionary dimension form, in fact, an access policy and would therefore be perfectly compatible with a mechanism like the one proposed. Before the contingency, a country could be considered to have applied for pre-qualification for the SiFF, or to have gained access to this facility as a precautionary measure. From the time purchases are made, the single facility would work as described. We might therefore conclude that the SiFF would replace the RAL's financing components and would be perfectly consistent with an access policy aiming to fulfil the RAL's insurance objectives.

4.2.5 EXIT STRATEGIES

Exit strategies are basically required because of the perception of countries that it is difficult to abandon their financial relationship with the IMF and the security it entails without causing alarm on the markets. A priori, the influence of a single facility on this question would be positive or neutral. On the one hand, with the SiFF, the current mechanisms which countries can rely on as an exit strategy [basically precautionary arrangements and Post-Program Monitoring¹⁷ (PPM)] could continue to operate in exactly the same way as at present. Moreover, as discussed above, a single facility would not interfere with the potential use of the RAL for this purpose, depending on its eventual design.

The establishment of a SiFF-type mechanism would also open up new possibilities for borrowers of a trauma-free exit from their financial relationship with the IMF. The greater flexibility for countries provided by the repayment periods of a SiFF could be used as a strategy to smooth their exit in certain cases.

4.2.6 LiA POLICY

In 1989 the IMF introduced its Lending into Arrears (LiA) policy¹⁸, departing from its previous position of intolerance of arrears to private creditors of countries applying for financial assistance. This policy basically establishes two conditions that should be fulfilled for the Fund to lend to countries in this situation. First, the IMF's financial assistance must be crucial to the success of the country's adjustment program and, second, the country must be applying appropriate measures and making a good faith effort to reach a collaborative agreement with its creditors. This second condition in turn manifests itself in the country having to maintain a dialogue with all its creditors, from the moment a restructuring is deemed to be necessary until it is completed, and in it sharing with them all appropriate, relevant and non-confidential information.

As in the case of the exceptional access framework referred to above, the suitability of the LiA policy under its current design is being debated. However, for the purposes of this article, justification of the IMF's involvement as lender in this type of situation is independent of how the financial assistance is given, so that the introduction of the SiFF would not interfere in the LiA policy.

¹⁷ The purpose of PPM is to provide additional supervision of the country's performance after the end of the arrangement and while the outstanding credit exceeds 100% of the quota.

¹⁸ This policy has since undergone diverse changes.

4.2.7 IMF FINANCES

A priori, the effect of introducing the SiFF on the IMF's finances would be small and of uncertain sign. In the event of relatively moderate crises, if the authorities take the appropriate measures at the right time, revenues might be expected to be reduced, owing to the greater incentive offered by the SiFF for efficient use of resources compared with the current facilities. However, the longer the remedial measures are put off and the more the purchases made, the higher the rate of charge applied and, thus, the larger the Fund's revenues. Also, market developments, which have a large bearing on the rapidity with which borrower countries may access credit again, will play a prominent role. Given the variety of factors involved it is very difficult to make predictions regarding the net effect on revenues. This effect will depend, moreover, on the quality of the IMF's analysis of the borrower country's financing needs when the program is designed.

However, the reform of IMF finances plays down the importance of all these considerations. As mentioned at the beginning of this paper, the Fund has already adopted measures (establishment of an Investment Account, gold sales, repayment of the administrative expenses of concessional credit and broadening the institution's capacity to invest) to increase the number of revenue sources and to dissociate them from its lending activity. Accordingly, the lending apparatus will become more manoeuvrable and independent, enabling it to be more effective in achieving its main objectives, which are those of the institution and no longer include covering all the IMF's expenditures.

4.3 *Antecedents*

The SiFF may be considered to have certain historical and theoretical antecedents. The former include the fact that, during an initial phase of the IMF's existence (from its foundation until 1974), charges increased with the duration of the loan and the amount drawn down, in order to discourage prolonged and excessive use of resources. However, there were important differences in other features of the lending mechanism that distort comparison and prevent the drawing of parallels; the complex division of outstanding credit into segments and the allocation method used (which divorced disbursements from repayments, since each repayment was used to cancel the least onerous disbursement and the higher charges were only eliminated upon complete repayment of the loan) had the opposite effect to that desired, thus making early repurchases unattractive.

During a second phase (1974-1981), charges no longer increased with volume and the number of time thresholds was reduced. The complexity of the previous system, the establishment of new facilities (some financed using official funds from outside the IMF that required a different treatment from those deriving from quotas) and the greater confidence in conditionality as a safeguard for IMF resources explain the change in the system. At the same time, the increase in market interest rates, to which creditor's remuneration was linked, led to the raising of the surcharges that varied with time. This system differs from the present one in that, as already seen, the evolution of charges depends on the facility considered.

Notable among the theoretical antecedents are certain ideas of IMF staff, which emerged in the context of a review of its financing instruments¹⁹ but were never implemented. First, the possibility of implementing a "single facility" was considered. Despite the nominal parallels, this proposal envisaged a rigid single facility, with a fixed maturity for all programs

19. IMF (2000).

and, also, a single rate of charge. The differences with respect to the mechanism proposed are clearly very large. There are more similarities with the idea, launched in this same review, of introducing a surcharge that varies with the duration and volume of financing. However, this proposal was based on the introduction of a surcharge of this type for each facility, so that the lending system would have been made considerably more complicated, contrary to the seminal idea of simplifying the lending apparatus. In addition, at that time, there was concern that the adoption of a system of incentives for shorter use of a smaller volume of IMF funds would substantially reduce the volume of outstanding credit and, therefore, the institution's revenues. Given the reform of Fund finances, aimed at dissociating revenues from outstanding credit, this disadvantage has lost its relevance.

To conclude this section, Table 3 briefly assesses the potential of the SiFF to improve the current lending framework on the basis of various criteria. Annex 1 compares the basic features of this instrument and of the existing facilities.

Comparative analysis of the SiFF and the current framework

Table 3

Criterion	Assessment	
Simplicity and clarity of the lending framework	Greater with the SiFF owing to its lower level of complexity	
Flexibility and adaptability	Greater with the SiFF as it covers the same needs as the current facilities and is less rigid in unforeseen situations	
Incentives structure	More complete in the SiFF as it involves the combined use of volume and time	
<i>Support for adoption of measures</i>	Greater	The cost structure of the SiFF gives incentives to use the lowest possible volume of funds for the shortest possible time
<i>Fund's resources turnover</i>	Greater	
<i>Risk of prolonged use</i>	Less	
<i>IMF's financial exposure</i>	Less	
Uniformity of treatment	Greater with the SiFF as it eliminates any possible discretionality in the granting of facilities	
Preventive use	Equivalent	
Access to funds	Identical. Subject to the same policies	
Safeguarding of resources	Same requirements for approval and the same conditionality for purchases. The SiFF also gives incentives for brief of limited funds, which reduces risks.	
Country ownership	The SiFF enables the debtor to be more involved in its program	

5 An illustrative practical approach

Having studied the current financing facilities and designed the proposed SiFF at the theoretical level, this section tests out a practical version of the SiFF concept. It uses it to perform an analysis comparing the costs generated by four actual programs under the current financing facilities, with those to which the application of the SiFF would have given rise.

5.1 Practical example

As with the IMF's current financing facilities, the function of the SiFF would not be continuous as depicted in Figure 2. The growth in cost, whether because of an increase in volume or in duration, would be established by tranches, measured in percentages of the quota and months, respectively.

The volume tranches should be defined on the basis of the quota since otherwise the cost-setting system would favour the smaller countries and penalise large ones. Even if the financing gaps of smaller countries were large in relative terms (e.g. as a percentage of GDP), in absolute terms they would be smaller than those of the big countries and, accordingly, the cost of their financing would be lower. In addition to being discriminatory, this might lead larger countries that consider themselves unfairly treated to avoid resorting to the institution if current or future financing alternatives allow it.

Moreover, the graphic depiction of the SiFF (see Figure 4) does not match the actual costs since the volume and time tranches, in practice, are not symmetrical. As a result, the practical translation of the proposed SiFF would be given by a double-entry table establishing the ebp_T for each combination of volume of outstanding credit and loan duration, at each point in time of the life of the loan. That is to say, the cost of financing would always be determined by the rate of charge (rc) plus two components: that depending on the time elapsed since the first disbursement (ebp_{vi}) and that determined by the amount still to be repaid (ebp_{vj}). This rate-setting grid or matrix (like that set out in the example in Table 4) would work as a decision-making guide to countries which, depending on the foreseeable duration and volume of financing, could consider a priori different combinations.

$$\text{Hence:} \quad C_T = rc + ebp_T$$

$$\text{where:} \quad ebp_T = ebp_{vi} + ebp_{vj} \quad / \quad i = 1 \dots n; \quad j = 1 \dots m$$

Table 4 is merely for illustrative purposes, as the SiFF might have different time and volume segments or different values for each tranche, albeit distributed in accordance with a similar structure. This specific example proposes two exemptions: one, a time allowance, during the first three years of the loan; and the other a volume-based allowance, for amounts due below 200% of the borrower's quota. Once this period has elapsed, the time-based cost grows by 50 ebp per annum, peaking at 200 ebp at the end of the sixth year. The charges for drawn-down volume begin at 100 ebp, when the amount is between 200% and 300% of the quota, and a further 100 ebp when the ceiling marked by the current access framework (300% of the quota) is exceeded. As from 400% of the quota the cost increases by 50 ebp for each drawdown of funds equivalent to 100% of the quota, up to a maximum of 550 ebp. As can be seen, the maximum ebp that would be charged

under the SiFF, according to this matrix, would be 750, which is the surcharge corresponding to a loan for an amount higher than 1000% of the quota and of more than 72 months.

Example of SiFF cost-setting matrix

Table 4

		volume (quota)	V ≤ 2Q	2Q < V ≤ 3Q	3Q < V ≤ 4Q	4Q < V ≤ 5Q	5Q < V ≤ 6Q	6Q < V ≤ 7Q	7Q < V ≤ 8Q	8Q < V ≤ 9Q	9Q < V ≤ 10Q	V > 10Q
time (months)												
t ≤ 36	ebp _{vi}	0	100	200	250	300	350	400	450	500	550	
	ebp _{ij}	0	0	0	0	0	0	0	0	0	0	0
	ebp _T	0	100	200	250	300	350	400	450	500	550	
36 < t ≤ 48	ebp _{vi}	0	100	200	250	300	350	400	450	500	550	
	ebp _{ij}	50	50	50	50	50	50	50	50	50	50	50
	ebp _T	50	150	250	300	350	400	450	500	550	600	600
48 < t ≤ 60	ebp _{vi}	0	100	200	250	300	350	400	450	500	550	
	ebp _{ij}	100	100	100	100	100	100	100	100	100	100	100
	ebp _T	100	200	300	350	400	450	500	550	600	650	650
60 < t ≤ 72	ebp _{vi}	0	100	200	250	300	350	400	450	500	550	
	ebp _{ij}	150	150	150	150	150	150	150	150	150	150	150
	ebp _T	150	250	350	400	450	500	550	600	650	700	700
t > 72	ebp _{vi}	0	100	200	250	300	350	400	450	500	550	
	ebp _{ij}	200	200	200	200	200	200	200	200	200	200	200
	ebp _T	200	300	400	450	500	550	600	650	700	750	750

Three further considerations on this example are worth noting. Firstly, in accordance with the considerations on the cost structure of the SRF, Table 4 switches the higher cost of this facility from the outset of the arrangement to the volume component of the cost of the SiFF.

Secondly, the time tranches envisaged in Table 4 are designed with a view to the need to cover, within reasonable costs, the programs currently routed through all facilities, including the EFF. This means the moment at which the time component of the cost is activated must be delayed, and that cost must grow in a limited fashion. However, it is worth considering whether such long-lasting and such structural programs as those financed by the EFF should remain within the preserve of the IMF. Were this not the case, the design of the SiFF matrix might envisage greater time charges, or the earlier appearance of the time component in the life of the program, and, at the same time, some easing in the volume-related component. That would allow a more balanced mix of these two components in most programs.

Thirdly, regarding the total cost of the SiFF, and bearing in mind the public good nature of the IMF (the granting of loans when the market is “closed”) and its role as a Lender of Final Resort (loans at lower-than-market rates subject to compliance with certain conditions), there would be scope for including a variable spread in the decision-making matrix. This negative spread would reduce the ebp expressed in the grid if, in the Board’s judgement, exceptionally difficult circumstances in the country’s balance of payments position, irrespective of the cause of such problems, were to justify a reduction in the cost of financing. In practice, the use of this type of mechanism would enable the Board to further lower the cost of IMF funds.

There would be two immediate consequences of adopting this spread. On one hand, it would increase the flexibility of the lending apparatus and, therefore, its capacity to adapt even to extreme circumstances. On the other, it would increase discretionality in

the calculation of loan costs and the scope for political interference in financing decisions, which clearly runs counter to the principles underpinning the SiFF. If it were deemed appropriate to adopt this spread, the means of curbing arbitrariness in decision-making would be to define, as specifically as possible, the minimum criteria for bounding the aforementioned "especially difficult circumstances". By way of example, the following could be considered: i) that access to markets is impossible, ii) that compliance with the program is satisfactory, and iii) that the country has exhausted all possible efforts of internal adjustment and private-sector involvement.

5.2 Application of the SiFF to four actual programs²⁰

Table 2 showed the average volume of access and the average duration of each of the IMF's financing facilities during the period under study. For this section, those programs that most closely match the standard use of each of these facilities, in accordance with this table (see Table 5), have been selected from among all the programs in the sample.

Selection of cases

Table 5

Country	Facility	Amount approved		Amount drawn down		Term of the arrangement	
		SDR millions	% quota	SDR millions	% quota	Start	End
Guayana	SBA	49.5	101	49.5	101	13-7-1990	12-7-1991
Panama	EFF	120.0	80	40.0	27	10-12-1997	9-12-2000
Korea	SBA	5,550.0	340	4,462.5	273	4-12-1997	3-12-2000
	SRF	9,950.0	609	9,950.0	609	18-12-1997	17-12-1998
Turkey	SBA	9,254.0	960	5,955.0	618	22-12-1999	21-12-2002
	SRF	5,784.0	600	5,784.0	600	21-12-2000	20-12-2001

According to this criterion, the program for Guyana has been chosen to represent the average SBA, and the Panamanian program for the EFF. As a standard SRF, which is a somewhat more complex case since it is always associated with an SBA, the financing extended to Korea during the south-east Asian crisis shall be used. In addition to these cases, the Turkish program established in December 1999 is also studied. This case is included because it is the program with the highest access ever.

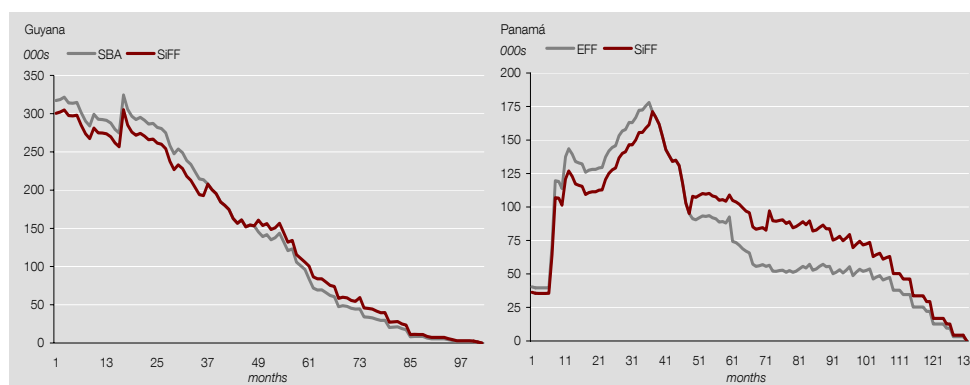
Chart 6 compares the cases of Guyana and Panama. As the volume drawn down did not exceed 200% of the respective quotas in either of the two programs, the minimum SiFF threshold for beginning to add ebp_v to the rc, all the ebp that would have been charged in these two cases would have been determined by the time component of the SiFF. It is easy to verify that during the first three years the use of the proposed facility would have been cheaper than that of the respective SBA and EFF. During the fourth year the cost would have been the same and, thereafter, the SiFF would have been more expensive. Accordingly, the cost incentives for Guyana and Panama to repay their debts to the IMF early and to promptly apply corrective measures would have been greater than with the facilities used. To incur the same financial cost as under the current facilities, these countries would have

²⁰. For clarity, cost refers solely in this section to the SDR rate plus the surcharges or ebp of the current facilities and the SiFF, respectively. It does not include adjustments for burden sharing and the profit target which would have to be included in all cases.

been able to choose, under a SiFF, between reducing their volume of outstanding credit at the same term or maintaining their exposure, but over a shorter term.

Cost of the SiFF in the cases of Guyana and Panama

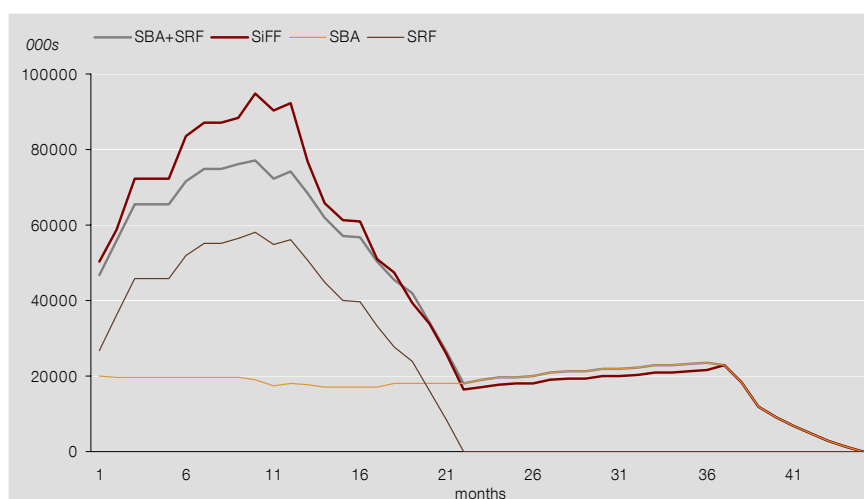
Chart 6



The analysis of the Korean case is slightly different. Chart 7, in addition to depicting the cost of the SiFF and the total cost of this program (SBA+SRF), tracks the individual course of the cost of these latter two facilities. During the first year and a half of the program the SiFF would have been more burdensome, given that it penalises high levels of credit more than the current facilities. After the first year, Korea began to return the credit extended through the SRF, which would have made the ebp of the SiFF fall progressively until converging with the cost of the actual program. The cost of the SRF, however, held on an upward course until its full repayment, in month 25, irrespective of the cost of the volume of outstanding credit, since penalisation is based solely on time. This is why, between months 12 and 22, the total cost of the Korean program did not decline as quickly as would have been the case under the SiFF. Subsequently, when the volume of outstanding credit diminished further, the SiFF would have been cheaper than the current facilities and only from the third year, when the SiFF would have begun to penalise the prolonged use of credit, would both costs have moved onto an equal footing.

Cost of the SiFF in the Korean case

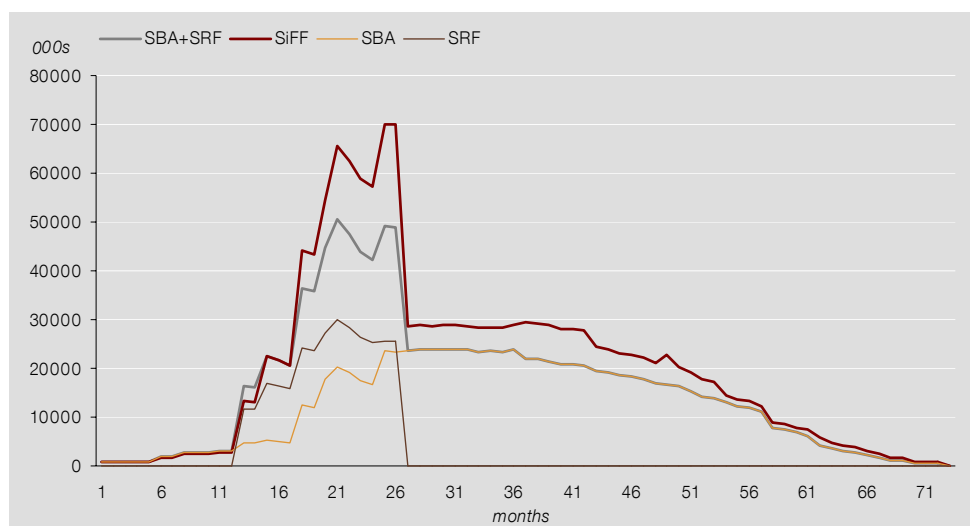
Chart 7



Finally, in the Turkish case, also comprising SRF and SBA, the drawdown of funds was gradual (see Chart 8). Had the SiFF been in place, this would have prompted a lower program cost in the first year and a half, before volumes surged with the granting of the SRF. Thereafter, the SiFF would have made the cost rise as the exorbitant levels of access of this program were reached between months 21 and 26. Later, the differences would have narrowed greatly as the volumes lent diminished, although the SiFF would have continued to be slightly more expensive due to the effect of the time component of the cost.

Cost of the SiFF in the Turkish case

Chart 8



All the cases set out support the objectives and incentives taken into account in the design of the SiFF. More specifically, a better use of the Fund's resources would have been encouraged by the reduction in the cost of financing below the *desired* time and volume thresholds and by the progressive penalisation of *excessively* long and voluminous access.

6 Conclusions

Over the course of time and with the emergence of new types of crisis, the IMF's loan granting mechanism has turned into a complex catalogue of financial facilities, owing to the institution's efforts to meet its members' needs by creating new facilities. The study of this mechanism reveals aspects that could be improved and updated. At the same time, analysis of the loans granted over the last seventeen years shows that lending was highly concentrated throughout the period in the SBA and SRF facilities, especially the former. In these conditions, the current low demand for IMF loans and the strategic review to which it has submitted, in particular, the reform of the Fund's finances, provides an excellent opportunity for a far-reaching examination of the IMF's lending activity and implementation of necessary reforms.

Accordingly this paper examines the possibility of reforming the lending mechanism in order to: i) simplify it, without any decline in its usefulness to the member countries; ii) increase its flexibility and adaptability to different needs; iii) strengthen its incentives structure, so as to minimise unnecessarily voluminous and lengthy use of funds and, finally, and iv) provide a uniform treatment for potential borrowers. The improvement in the incentive system would, moreover, stimulate prompt adoption of measures by the debtor country, boost IMF funds turnover, tackle the problems arising from prolonged use of resources and limit the institution's financial exposure to strictly necessary levels.

To achieve these objectives, this paper proposes replacing the current range of instruments with a single financial facility, capable of fulfilling the various functions attributed to the existing instruments, with the added value that it would eliminate any possible discretionality in facility allocation.

The main characteristics of this single financial facility would be, first, variable costs that depend at all times on the volume draw down and time elapsed from the first purchase and, second, flexible maturities adaptable to the needs of each case. A cost structure of this type would aim to reward adjusted use of funds, in terms of duration and volume (as a percentage of the quota) and would penalise credits exceeding the thresholds for these variables determined by the IMF's Executive Board. The ad hoc arrangement and repayment periods would make the system more readily adaptable to the specific requirements of each borrower. At the same time, the possibility of studying different volume and duration combinations, always within the limits of the program agreed with the IMF, would allow higher degrees of country ownership.

It should be noted that although a mechanism with these characteristics would tend to make credit cheaper in certain circumstances, and would make maturities more flexible, its introduction would not entail any relaxation of the requirements for gaining access to IMF financing, nor would it reduce the level of strictness in compliance with conditionality. Simultaneously, the introduction of a single facility would reinforce the policies governing the IMF's lending activity, or would at least not conflict with them.

On the basis of these assumptions, a possible practical application of this new instrument is also presented. For this purpose a double-entry table or matrix is constructed, which assigns a specific cost to each combination of volume and duration. The matrix so

obtained is tested using four actual programs, representative of the recent history of the IMF. The costs actually incurred are compared with those that would have resulted from applying the proposed matrix. This study endorses the potential of this type of facility to achieve the objectives that have informed its design, to the benefit of all members of the institution.

Annex 1

Characteristics of the current facilities and of the SIFF

Characteristics	SBA	EFF	SRF	CFF	EAF	SIFF
Objectives	Resolution of short-term external imbalances	Resolution of longer-term external imbalances	Resolution of exceptional external imbalances	To counteract exogenous commodity price shocks	Assistance following a natural disaster or armed conflict	All the aforementioned objectives
Access	Normal	100% per annum cumulative total	300%	No limits	10-55%	The same limits as with the current facilities, according to the objective of the SIFF
	Exceptional	Compliance with the Exceptional Access Framework or the Exceptional Circumstances Clause			None	The same requirements as in the case of the SBA, EFF and SRF facilities
Surcharges	According to volume drawn down; maximum 200 bp	According to volume drawn down; maximum 500 bp	According to volume drawn down; maximum 200 bp	According to volume drawn down; maximum 200 bp	None	According to volume drawn down and duration
Periods	Arrangement	12-18 months (maximum 36)	36 months (maximum 48)	Maximum 12 months	-	According to the conditionality applicable
	Repayment	27-48 months	54-120 months	24-36 months	27-60 months	According to the borrower's needs and debt profile

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