

# Review of the IMF's lending framework

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## Introduction

Since the IMF's inception, there have been several major changes in the world economy of relevance for its lending operations. Advanced countries stopped borrowing from the Fund in the 1980s when more fragile middle-income emerging markets became the biggest IMF borrowers. More importantly, globalisation and financial deepening broadened the range of channels through which real and financial shocks could affect individual economies and spill over to other countries. Cross-border flows and rising financial linkages changed the profile of risks that members face, inter alia, by deepening vulnerabilities, amplifying the effects of various shocks, and transmitting them more quickly across national borders. Meanwhile, the ability to influence private creditors diminished as bonds largely replaced loans, implying that private creditors were less subject to regulatory suasion. As a result, IMF members' needs to borrow from the Fund have changed, as reflected in a change in the size and duration of financing arrangements.

The growing magnitude of private financing flows and the emergence of capital account crises made the signalling effect of the Fund's financing increasingly important. Short-term balance of payments pressures experienced by some members were perceived to be the result of «speculative» capital flows, resulting from rapid shifts in market perceptions or from misunderstandings of policies by markets. At the same time, the massive capital movements that triggered capital account crises dwarfed the amounts that the Fund could deploy. These factors gave prominence to the Fund's signalling role and the catalytic effect of IMF financing.

Similar developments have also been observed during the financial crisis that began in 2007. The scale of the problems in some countries affected by the crisis led the Fund to grant exceptional amounts of financial assistance at short notice. Also, the magnitude of the financing requirements prompted the Fund to call upon other sources of financial support in addition to its own assistance.

From time to time, the Fund has adapted its financial toolkit in response to a changing world and the evolving needs of its membership by redesigning, creating or terminating individual facilities and adapting its financing policies. To illustrate this, for instance, the Compensatory Financing Facility (CFF) has gone through several cycles of liberalisation and tightening with developments in world commodity markets and as the Fund has tried to strike the right balance between financing and conditionality. Other examples of how the Fund has adapted its array of financial facilities to new circumstances are the Supplemental Reserve Facility (SRF) and the Contingent Credit Line (CCL). The SRF was adopted at the height of the Asian financial crisis in 1997 to lend to countries with large short-term financing needs stemming from a sudden collapse of market confidence. Shortly after the establishment of the SRF, the Fund set up the CCL as a precautionary line of defence against the spread of capital-account-driven crises. Due to a lack of demand by potential users, the CCL was nevertheless wound up at the end of 2003.

More recently, in light of worsening global economic conditions, the IMF has introduced some modifications to one of its concessional lending facilities, the Exogenous Shocks Facility (ESF) to better meet the needs of its low-income members. Furthermore, it set up a new non-concessional Short-Term Liquidity Facility (SLF), which is

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designed to help members facing exceptional balance of payments difficulties arising from external market developments despite strong underlying fundamentals and domestic policies.

Consequently, after over 50 years of evolution, the Fund now has at its disposal a large arsenal of financial facilities<sup>(1)</sup>, which are the result of its efforts to keep its relevance in a changing world. Nevertheless, lending instruments and policies have often been created and adapted on an ad hoc basis with specific balance of payments difficulties in mind. As a result, eligibility criteria, access policies and the charges and maturities schedules of the Fund's lending instruments are often not mutually aligned, leading to a complex web of facilities and policies.

The IMF is therefore currently reviewing its lending instruments and access policies as one of the priority efforts underway to refocus and modernise its work in the context of its ongoing overall strategic review. The purpose of this paper is to provide an input into this discussion.

The paper is structured as follows. Section I gives an overview of the Fund's current lending facilities and the policies governing them. Section II details the issues concerning the Fund's lending framework. More specifically, this section illustrates how some of the Fund's lending facilities may have lost their relevance, that gaps could be perceived in the current lending framework and why the framework itself seems fragmented and overly complex. These issues can affect the credibility of the Fund's lending framework and hence the perceived legitimacy of the institution. Note that the discussion on the appropriateness of quotas<sup>(2)</sup> as a metric on which to base access to Fund resources falls outside the scope of this paper. Finally, in section III, some options are proposed to address the issues raised in section II. Three possibilities are put forward: (i) a multi-facility framework, with one facility for each type of balance of payments need, (ii) a single flexible facility and (iii) a dual framework, consisting of two facilities.

## 1. The Fund's current lending framework : overview

The Fund's lending framework currently consists of two concessional and seven nonconcessional lending instruments. This paper will only consider the Fund's facilities in the General Resources Account (GRA), i.e. the IMF's non-concessional facilities, which are subsequently discussed in this section.

From its early history, IMF credit has been made available in tranches. A purchase in the *first credit tranche* involves the use of IMF credit of not more than 25 p.c. of quota. The upper credit tranches refer to any use of IMF credit beyond the first credit tranche. Resources drawn in the credit tranches can be used to meet any balance of payments need. The IMF has a more liberal attitude to making resources available in the first credit tranche than in the upper credit tranches, provided that the member is making reasonable efforts to solve its balance of payments problems. Access to the upper credit tranches is normally provided under a *Stand-By Arrangement (SBA)*, which is designed to help countries address short- to medium-term actual or potential balance of payments needs. SBAs have existed since 1952 and have provided the bulk of IMF funding.

In 1963, the Fund established the *Compensatory Financing Facility* in response to fluctuations in the prices of primary commodities that afflicted many countries in almost every region around the globe. The main purpose of compensatory financing is to ensure timely financing for members that are experiencing balance of payments difficulties resulting from either a sudden shortfall in export earnings or an increase in the cost of imported cereals.

The *Extended Fund Facility (EFF)* was established in 1974 as a vehicle aimed at overcoming actual or potential balance of payments difficulties resulting from macro-economic and structural problems. The creation of the EFF reflected an increasing recognition that balance of payments problems could have structural origins and thus could require both an extended period of adjustment and policy changes that would strengthen the productive and export base of the economy.

In 1982, the Fund developed the policy on *emergency assistance* for natural disasters, and just over a decade later adopted similar procedures for post-conflict cases. The *Supplemental Reserve Facility (SRF)* was established in late 1997. The purpose of the SRF is to provide assistance to members that are experiencing exceptional balance of payments difficulties due to a large, short-term financing need resulting from a sudden and disruptive loss of market confidence, reflected in pressure on the capital account and the member's reserves. SRF resources are provided under Stand-By or Extended Arrangements in addition to credit tranche or EFF resources.

(1) For the sake of simplicity, the paper refers collectively to the various policies on the use of Fund resources as "facilities", while this term normally only refers to those policies on the use of Fund resources that fall outside the credit tranches.

(2) A member's quota is the capital subscription, expressed in SDRs, that a country must pay to the IMF on joining. Up to 25 p.c. is payable in SDRs or other acceptable reserve assets and the remainder in the member's own currency. Quotas, which reflect members' relative size in the world economy, are normally reviewed and adjusted, if necessary, every five years.

The SRF is not subject to explicit access *limits*, in contrast to the SBA and the EFF. In fact, access by a member to the Fund's resources in the credit tranches and under Extended Arrangements is subject to a limit of 100 p.c. of quota on an annual basis and 300 p.c. cumulatively. There is also a separate "global" limit of 100 p.c. of quota annually and 300 p.c. cumulatively which applies to overall access by members to the Fund's general resources (i.e. to aggregate access across all GRA facilities and policies)<sup>(1)</sup>. These access limits serve several purposes. They give members confidence about the degree of financial support that the Fund is normally prepared to provide, and encourage an appropriate balance with each member's adjustment policies, and other sources of financing. The annual limit helps to ensure that members do not exhaust their total potential access to the Fund more rapidly than would be warranted by the nature and size of shocks, while the cumulative limit reduces the risk of the Fund's resources being exhausted, so that members are not treated on a first-come-first-served basis. The access limits also reduce the risk of members finding themselves unable to repay the Fund, thereby safeguarding IMF resources. Access limits have important financial implications for IMF programme countries since they determine the amount of Fund credit that is subject to surcharges and set an important threshold beyond which access decisions are subject to greater scrutiny.

Access can indeed exceed these limits in "exceptional circumstances" (i.e. under "the exceptional circumstances clause"). As the Fund expected that the vast majority of cases where exceptional access could be considered would be in capital account crises, an *exceptional access framework* was designed in 2003 with these cases in mind. This framework defines four substantive criteria<sup>(2)</sup>, procedures for early consultation with the Board, additional information disclosure requirements to raise the burden of proof and *ex-post* evaluations of programmes that apply for exceptional access in capital account crises.

However, on the occasion of the 2004 review of the exceptional access framework, it was decided that these criteria and procedures should be applied to all requests for exceptional access, i.e. for both capital and non-capital account cases. There nevertheless remains an important distinction differentiating the treatment of capital from non-capital account crises. In fact, in capital account cases, the four substantive criteria must be met in order for exceptional access to be approved under the exceptional circumstances clause. Moreover, in cases of exceptional access in capital account crises, there is a strong presumption that access will be provided using resources under the SRF, where the conditions for this facility apply<sup>(3)</sup>. This presumption was strengthened in 2003 and again in

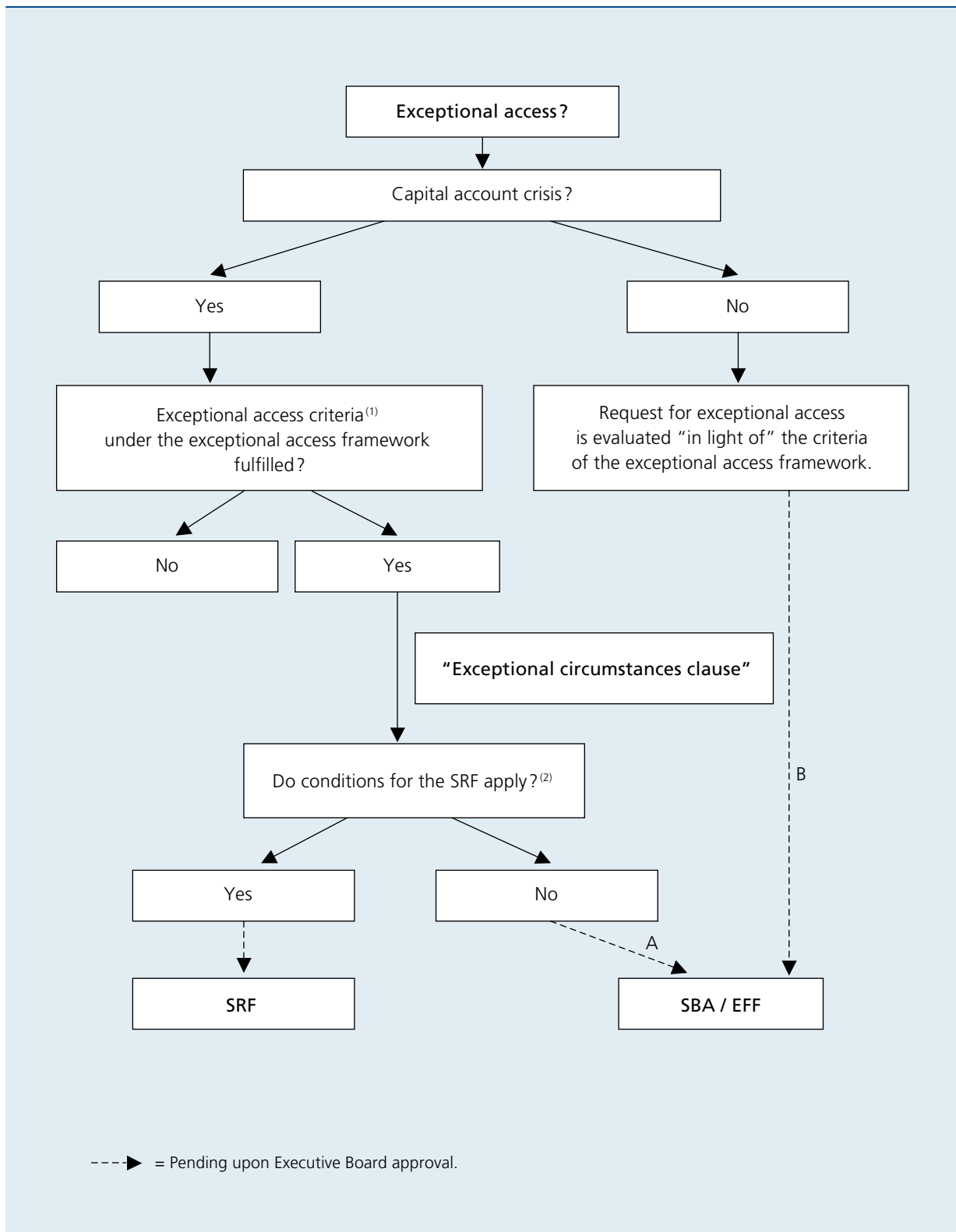
2004. Notwithstanding, it should be noted that the SRF Decision acknowledges that not all capital account crises can be resolved within the short SRF maturity.

In non-capital account cases on the other hand, requests for access above the limits need to be justified "in light of the four substantive criteria». In other words, observance of all criteria is not a requirement in these cases and the Board has the flexibility to grant high access under the exceptional circumstances clause.

(1) Accordingly, the effective limits on credit tranche and EFF access are lower if a member uses Fund resources under another facility, such as emergency assistance or the CFF.

(2) These four criteria include: (i) balance of payments pressure on the capital account resulting in a need for IMF financing that cannot be met within the normal access limits; (ii) a high probability that debt will remain sustainable established on the basis of a rigorous and systematic analysis; (iii) good prospects for the member to regain access to private capital markets while Fund resources are still outstanding and (iv) a strong adjustment programme adopted by the member that provides a reasonable strong prospect of success, including not only the member's adjustment plans but also its institutional and political capacity to deliver that adjustment".

(3) SRF support can only be provided "to a member that is experiencing exceptional balance of payments difficulties due to a large short-term financing need resulting from a sudden and disruptive loss of market confidence reflected in pressure on the capital account and the member's reserves".



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(2) The SRF Decision sets out a very specific circumstance test: SRF support would only be provided "to a member that is experiencing exceptional balance of payments difficulties due to a large short-term financing need resulting from a sudden and disruptive loss of market confidence reflected in pressure on the capital account and the member's reserves."

The chart on the left gives a schematic overview of the Fund's exceptional access policy.

When a member seeks an IMF-supported programme but does not face a pressing balance of payments need, it may treat a Fund arrangement as *precautionary*, i.e. a Stand-By or Extended Arrangement under which the member has indicated its intention not to make purchases. Members may cease to treat an arrangement as *precautionary* at any time and make purchases under it as long as the conditions set by the arrangement have been met. *Precautionary* programmes can provide a valuable service in lending credibility to authorities' policies, while sending a well-calibrated signal to markets.

The table below specifies the modalities of the Fund's current nonconcessional facilities.

Table 1 details the *charges* that are applied to the different Fund facilities. Surcharges are added to the basic rate of charge to strengthen the incentives for members to avoid maintaining large Fund exposure and to encourage early repayment, accordingly preserving the revolving nature of Fund financing. SRF surcharges are time-based – i.e. differentiated according to the period of use – while surcharges in the credit tranches and under the EFF are level-based – i.e. differentiated according to the level of use.

The table also shows the *repurchase modalities*<sup>(1)</sup> – including predetermined repurchase schedules and the frequency of repurchase instalments<sup>(2)</sup> – for each of the

different Fund facilities. The IMF's repurchase policies are intended to ensure the revolving nature of its resources. The Fund's repurchase policy is guided by its Articles of Agreement, which define fixed repurchase periods for IMF lending (Article V, Section 7(c)) and provide for early repurchases by members as their balance of payments and reserve position improves (Article V, Section 7(b)). A major change to these repurchase policies was introduced in 1997 with the establishment of the SRF. In line with the short-term nature of this type of balance of payments need, the SRF, as the table above shows, incorporates much shorter repurchase periods and features predetermined schedules of repurchase expectations that are legally outside the framework of Article V, Section 7(b). As for purchases in the credit tranches and under the EFF and the CFF, repurchase expectation schedules were introduced in 2000, in the context of the review of IMF facilities. Hence, for most purchases, a borrower is expected to repurchase according to the relevant schedule of repurchase expectations which is earlier than under the schedule of repurchase obligations.

Time-based repurchase expectations can be extended upon request by the member, in which case repurchases fall due according to the original obligation schedule. Waivers are considered by the Board if a member's external position

- (1) When a member draws on the IMF's general resources, it does so by purchasing SDRs or other members' currencies in exchange for its own (domestic) currency. The IMF's general resources are, by nature, revolving: purchases (or drawings) have to be reversed by repurchases (or repayments) in instalments within the period specified for a particular policy or facility.
- (2) Purchase and repurchase schedules and the frequency of instalments together determine the maturity of an IMF lending facility.

**TABLE 1** GENERAL TERMS OF IMF FACILITIES IN THE GRA<sup>(1)</sup>

Instrument	Charges				Repurchases		
	Base	Surcharge	Service	Commitment	Expectation	Obligation	Instalments
1. First credit tranche		None		None	2.25 – 4 years	3.25 – 5 years	Quarterly
2. SBA		100 basis points for credit over 200 p.c. of quota;		25 basis points plus 10 basis points for amounts in excess of 100 p.c. of quota	4.5 – 7 years	4.5 – 10 years	Semi-annual
3. EFF		200 basis points for credit over 300 p.c. of quota	50 basis points		2 – 2.5 years	2.5 – 3 years	Semi-annual
4. SRF	Basic rate <sup>(2)</sup>	300-500 basis points initial surcharge rises by 50 basis points after 1 year and each subsequent 6 months <sup>(3)</sup>					
5. CFF		None		None	2.25 – 4 years	3.25 – 5 years	Quarterly
6. Emergency Assistance		None		None	None	3.25 – 5 years	Quarterly

(1) The table does not include the most recently created Short-Term Liquidity Facility (SLF), given the special nature of this facility, involving no Fund arrangement providing a framework for policy monitoring.

(2) The basic rate of charge is the interest charge that is applied to outstanding IMF credit financed from the IMF's general resources. It is set as a portion of the weekly SDR interest rate. Note that emergency loans are subject to the basic rate of charge, although interest subsidies are available, subject to availability, for countries eligible for the Poverty Reduction and Growth Facility, one of the Fund's concessional lending instruments.

(3) SRF resources are provided under Stand-By or Extended Arrangements for access above the access limits applicable to credit tranche or EFF resources.

is not strong enough for it to repay early without undue hardship or risk. Adjustment programmes supported by credit tranche or EFF resources are generally designed on the basis of the obligation schedule for repurchases, so that in most cases members will be in a position to meet repurchase expectations only if their external position is stronger than projected at the outset of the programme. In contrast, adjustment programmes supported by SRF resources are designed on the basis of the repurchase expectations schedule. Whereas under an SBA or EFF the Executive Board can allow a country to repay at the obligation date, without policy-related conditions, a similar decision under the SRF requires the Board to be satisfied with the country's policy stance. Nevertheless, the "policy test" for extensions of SRF repurchase expectations has been interpreted with flexibility.

In order to better align the modalities of the SRF to the diversity in duration of balance of payments needs experienced in capital account crises, the maturity structure of the facility was lengthened in 2003, i.e. when the exceptional access framework was set up. It was decided to extend the maturity of SRF repurchase expectations by one year and that of repurchase obligations by six months. Nevertheless, these are still shorter than under the SBA or EFF.

Finally, the Fund is also discussing the design of a possible new liquidity instrument, tentatively named the *Rapid Access Line (RAL)*. In fact, many emerging markets see an unmet need for insurance against large and volatile capital flows. Fund members, however, have mixed views about some elements of the design of such a facility, making it difficult to reach a consensus for an instrument that would be useful and actually used in practice. In this context, alternative design proposals for the RAL have been put forward under the form of a *Financial Stability Line (FSL)*<sup>(1)</sup> or *Rapid Liquidity Line (RLL)*<sup>(2)</sup>. The FSL would aim to guarantee availability of finance for countries which are in the process of integrating into the international financial markets should there be a sharp reversal in capital flows. The RLL would be geared towards countries already integrated into international financial markets that follow basically sound economic policies to address the problem of capital outflows as a result of turbulence in global capital markets.

In this context and in light of the ongoing financial turmoil, the IMF decided, in October 2008, to create the *Short-Term Liquidity Facility (SLF)*, to complement the Fund's traditional facilities described in table 1 above. This new facility is designed to help members facing short-term, self-correcting balance of payments pressures, providing liquidity support to members with a very strong

policy track record and a sound policy framework. Access under the facility is up to 500 p.c. of quota, available in the form of outright purchases, and limited to three outright purchases per 12-month period. The exceptional access framework nevertheless does not apply for purchases under the SLF as the members concerned are subject only to the substantive and procedural requirements specified in the SLF Decision. The SLF furthermore involves no formal ex-post conditionality, hence the nature of the balance of payments problem and the related pre-qualification framework constitute the key safeguard for the Fund. All this makes the SLF a somewhat "special facility" within the IMF's lending toolkit. Use of the facility is subject to the same charges and surcharges as in the credit tranches.

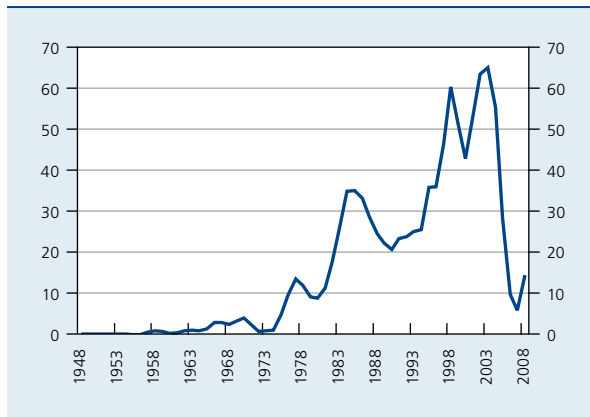
To conclude this section, the chart below charts the evolution, over the last 60 years, of IMF credit outstanding through its various nonconcessional lending instruments.

As the chart shows, the volume of loans provided by the IMF in the GRA has fluctuated significantly over time. For the first few years after the IMF was established in 1947, there was very limited use of IMF credit because most developing countries had emerged from the World War II commodity boom with substantial foreign exchange reserves, and European countries that had access to Marshall Plan funds were discouraged from drawing on IMF resources. Aggregate use of Fund resources picked up during the 1960s, as countries experienced balance of payments difficulties and the Bretton Woods system came increasingly under strain. The collapse of Bretton Woods itself – together with the move to floating exchange rates by the industrialised countries – reduced the demand for IMF resources. However, the number of arrangements and volume of IMF credit outstanding soon picked up again in the aftermath of the 1973 and 1979 oil shocks. The number of arrangements in place peaked during the debt crisis in the first half of the 1980s, but had almost halved by 1989 as these countries emerged from the debt crisis, and private capital flows resumed in the early 1990s. Demand for IMF credit increased again in the first half of the 1990s, when the Fund became involved in helping members' transition from centrally planned to market economies, followed by a series of exceptionally large programmes to deal with capital account crises – beginning with Mexico in 1995 and including the Asian crisis countries, as well as Argentina, Brazil and Turkey. Aggregate use of IMF resources peaked in 1998 and 2003 before plummeting in 2005 owing to early repurchases.

(1) Provided by Executive Directors Bakker and Warjiyo on May 22, 2008.

(2) Provided by Executive Director Nogueira Batista and Senior Advisor to Executive Director Mori on September 8, 2008.

**CHART 2** IMF CREDIT OUTSTANDING IN THE GENERAL RESOURCES ACCOUNT, 1948-2008 <sup>(1)</sup>  
(in billions of SDRs)



(1) Data as of end April for 1948-1983, end December for 1984-2007 and November 15 for 2008.

Additional early repurchases further reduced the level of outstanding IMF resources, to below 10 billion SDR<sup>(1)</sup> until end October 2008. Since then, the IMF has been granting exceptional access loans as the global financial crisis is unfolding. The loans provided to Hungary and Ukraine already raised the amount of credit outstanding to more than 14 billion SDR (situation as of November 15, 2008).

## 2. The Fund's current lending framework: issues at stake

As illustrated above, the IMF's financial assistance instruments as they exist today are the result of the Fund's efforts to retain its relevance in an ever-changing world. In an attempt to adapt to changing circumstances, the Fund has over the years redesigned its arsenal of lending facilities and fleshed out its financing policies. Nevertheless, lending instruments and policies were often created and adapted on an ad hoc basis with specific balance of payments difficulties in mind. Consequently, eligibility criteria, access policies and the charges and maturities schedules of the Fund's lending instruments are often not mutually aligned. Only once, in fact, did the Fund undertake a comprehensive review of its financial facilities structure as a whole (2000). Since then, the Board has only assessed specific aspects of its lending structure during regular targeted reviews.

As a result, the IMF lacks an integrated lending framework. Due to changes in members' lending needs and to the creation or adjustment of policies and facilities, some of the Fund's instruments may have lost their relevance,

too. Questions have also been raised whether there might be gaps in the IMF's current lending toolkit. Its current lending policies are also often perceived, by both users and markets, as being too complex and fragmented. These issues can affect the credibility of the IMF's lending framework and, ultimately, the perceived legitimacy of the institution.

### 2.1 Some lending facilities may have lost their relevance

As early as the 2000 review of IMF facilities, it was observed that members make much less use of the Fund's more specialised facilities, which are designed to deal with specific contingencies and events. On that occasion, IMF staff already felt there was a case for the elimination of all the more specialised facilities. This argument was based on a combination of design features and changes in the world economy that have, or perhaps should have, made the instruments fall into disuse. At that time, the Board decided to terminate four special facilities that had gone virtually unused, in an effort to streamline and simplify the Fund's lending structure. Today, the Fund still has one specialised nonconcessional facility, the CFF.

The CFF has been reviewed several times, most recently in 2000 and 2004. Nevertheless, it has not been used since 1999, despite the changes introduced in 2000 and some temporary and exogenous shocks that have affected several members since. Although IMF staff discussed the possibility of CFF access with a number of members concerned, these countries decided to use other options to deal with the shocks. Most of the middle-income countries concerned generally managed to weather the storm through a combination of non-IMF financing, use of reserves, and, in a few cases, greater exchange rate flexibility. As for the low-income members affected by the shocks, several of them resorted to alternative forms of IMF financing, including augmentations under the Poverty Reduction and Growth Facility (PRGF)<sup>(2)</sup> and *Emergency assistance*. Others that might have qualified did not feel a need for an augmentation under the PRGF, while some countries had other financing options on more attractive terms than under the nonconcessional CFF.

(1) The SDR is an international reserve asset, created by the IMF in 1969 to supplement the existing official reserves of member countries. SDRs are allocated to member countries in proportion to their IMF quotas. The SDR also serves as the unit of account of the IMF and some other international organisations. Its value is defined as a basket of key international currencies, consisting of the euro, Japanese yen, pound sterling, and US dollar. The SDR *interest rate* provides the basis for calculating the interest charged to members on regular (nonconcessional) IMF loans, the interest paid and charged to members on their SDR holdings, and the interest paid to members on a portion of their quota subscriptions. The SDR interest rate is determined weekly and is based on a weighted average of representative interest rates on short-term debt in the money markets of the SDR basket currencies.

(2) The PRGF is one of the IMF's concessional lending instruments.



Against this background, the Board had considered terminating the CFF at the time of its 2004 review. However, most Directors were willing to keep it on in its current form until the next review, both to give the facility extra time to prove its usefulness and in recognition that it would take some time to develop and gauge the usefulness of the new financing instruments currently being considered for low-income countries. They suggested that, in the absence of any clear demand for the CFF by the time of the next review, the facility should be dropped. Nevertheless, the CFF has not been reviewed again since 2004.

In 2006, the Fund introduced a new lending instrument, the ESF, which covers exogenous shocks faced by low-income countries, including any event beyond the control of a member's authorities and with a significant negative impact on the economy. In other words, there could be some overlap between the events that the ESF and the CFF were designed to cover. What distinguishes ESF financing is that it is more concessional than under the CFF and is similar to a PRGF arrangement. It also requires a comprehensive economic programme to be drawn up. Nevertheless, instead of creating a new lending instrument, the Fund could also have considered making the circumstances covered by the CFF less restrictive, for instance by redesigning it so it would have covered the cases currently targeted by the ESF. The apparent ineffectiveness of the CFF would have justified this option.

While the CFF has not been used since 1999, the need for Extended Arrangements has also proved to be fairly limited over recent years. Although the EFF is still used by the Fund, most recently in the case of Liberia (a blend with a PRGF arrangement), its value added might have decreased as the IMF has been granting longer and successive SBAs to its members. From the IMF's own viewpoint, it can also be preferable to provide renewed financing with adequate conditionality rather than upfront medium-term assistance. Under the existing EFF policy, the Fund does in fact have less assurance that it will be able to establish active cooperation with the country for solving its medium-term problems. The EFF was furthermore initially designed for members facing protracted balance of payments problems stemming from entrenched first-generation structural distortions. Nowadays, however, almost all adjustment programmes have large structural components. In this context, thought could be given to the value added of the EFF in comparison with the SBA.

## 2.2 Gaps perceived in the current lending structure

Questions have also been raised as to whether there might be gaps in the Fund's current lending framework.

Part of the criticism relates to the fact that, currently, normal access limits under the IMF's main financing facilities are purely based on a member's actual quota. As the globalisation of financial flows continues, these limits for non-exceptional access are likely to become increasingly low in comparison to members' potential needs. In this context, there have been calls for the normal access limits to be raised and for alternative criteria for determining a country's financing needs and its capacity to repay to be explored. While recognising the potential erosion of the resources available for some members under the current limits for normal access, this issue will not be taken up again in this paper.

Furthermore, gaps have been perceived in the IMF's exceptional access framework.

As illustrated in chart 1, the IMF's exceptional access policy makes an important distinction between the treatment of capital account and non-capital account crises. It should first of all be noted that, in practice, this distinction is not always straightforward and often entails some degree of judgement.

Moreover, since the SRF was designed especially for members in capital account crises with short-term exceptional access needs, the facility is ill-suited for members facing a capital account crisis with more protracted high access needs. Indeed, the SRF Decision explicitly recognises that not all capital account crises might be resolved within the short SRF maturity. But, as IMF staff have repeatedly argued, it is very difficult to determine ex ante the duration of a member's financing needs. Moreover, the experience with capital account crises shows a greater variance in the duration of countries' balance of payments needs than originally expected, indicating that the repayment terms for the SRF may not always be adequate ("A" in chart 1). In a number of recent capital account cases involving exceptional access, the Fund has indeed provided high access in the credit tranches or under an Extended Arrangement, as the concerned member's financing need was deemed medium-term. As a result, while the SRF was intended to serve as the main vehicle for exceptional access in cases involving capital account pressures, such access has increasingly been granted under an SBA or EFF.



To illustrate this, in the first arrangements that included an SRF (Korea (1997), Russia (1998) and Brazil (1998)), all exceptional access was provided under the SRF. In subsequent capital account exceptional access cases, however, the IMF provided (at least part of the) exceptional access on credit tranche terms. The Fund recognised the special nature of these exceptional access cases, including Turkey (2000), Argentina (2001) and Uruguay (2002), where a longer period of continued IMF engagement was deemed consistent with the projected balance of payments needs. A key distinction in these cases has been high levels of public debt, sustained high debt-servicing requirements and the longer time span needed to reinforce solvency. Nevertheless, the way in which they were handled has raised questions about how to make sure that a country is using the best facility on hand to address a particular balance of payments need. The relative cost of the different IMF facilities should provide the right incentives to this end. However, this is not the case at present. Although the duration of the SRF is shorter than that of the SBA or EFF, the surcharge on SRF loans is higher than the surcharge for high access under an SBA or EFF.

There seem to be other gaps in the Fund's exceptional access framework, too. As this framework was designed with capital account crises in mind, the four substantive criteria underpinning the framework have mainly provided guidance and constraints where exceptional access was considered most appropriate, i.e. for capital account crises. On the other hand, the framework has provided less clarity in other cases, since observance of the four criteria is not a requirement in non-capital account crises and the restrictive circumstances test for the SRF precludes use of the facility outside capital account crises and in *precautionary* settings ("B" in chart 1). Indeed, requests for exceptional access outside a capital account crisis have occurred in cases where members had pre-existing high exposure to the Fund, a potential rather than an actual need and in "other exceptional circumstances". In fact, recent decisions to grant exceptional access (Brazil (2003), Argentina (2003), Turkey (2005) and Uruguay (2005)) involved members that were not experiencing pressures in their capital account. Hence, these members' requests for exceptional access were only tested "in light of the four exceptional access criteria" and access was provided under the SBA. For Brazil (2003), it was acknowledged that there was no actual balance of payments need (as required under the first criterion of the exceptional access framework, see footnote 1 in chart 1) and that re-entry to capital markets was not directly applicable since Brazil had such access (third criterion). The country had furthermore indicated that it wanted to treat its arrangement as *precautionary*. Argentina's (2003) debt was considered not to be sustainable in the absence of a restructuring

effort (second criterion) and prospects were not good for regaining access to international capital markets within the period that Fund resources were outstanding (third criterion). In the case of Turkey (2005), the debt sustainability analysis underlined that the country's debt outlook remained highly vulnerable to shocks (second criterion) and re-entry to capital markets was not directly applicable since Turkey had retained market access (third criterion). Likewise with Uruguay (2005), downside risks to debt sustainability were considerable (second criterion) and the country had also already regained market access (third criterion).

In these cases, exceptional access has been granted even though all four substantive criteria were not met. While the exceptional access framework allows for such pragmatism, the Fund's decisions in these cases have led to the perception that exceptional access decisions in non-capital account crises are made on an *ad hoc* basis.

The newly-created SLF is an extreme case in point as it explicitly acknowledges that it might be justified to grant exceptional access to countries that do not necessarily satisfy all criteria stipulated in the exceptional access framework. Indeed, as explained above, the exceptional access framework does not apply when a purchase is requested under the SLF even though the latter can involve access up to 500 p.c. of quota.

Many emerging market economies have perceived yet another gap in the Fund's financing framework as they are calling for a lending instrument that would provide insurance against large and volatile capital flows. Discussions are continuing within the IMF on the desirability and possible design of a new lending facility to accommodate these countries' needs (see section I). It is in this context that the Fund recently decided to establish the new SLF. Nevertheless, the SLF is only available for countries that are well-integrated into global capital markets and with strong macroeconomic positions and records of consistent policy implementation. Moreover, in light of the scale of global capital flows, several emerging market economies find the access limit under the SLF still too low.

Finally, there are indications that middle-income countries, the major IMF borrowers in the credit tranches, are increasingly seeking sources of official financial support outside the Fund. Recent examples include the BIS loans to Argentina in 2007 and 2008, the use of a Deferred Drawdown Option from the World Bank by Colombia, Mexico and Uruguay, recent discussions on a World Bank Development Policy Loan for some EU Member States, bilateral and multilateral – other than from the IMF – financial assistance for some countries during the ongoing

financial turmoil. Thought should be given to whether the IMF ought to have a role to play in these cases and, if so, why the countries concerned have not found an adequate financing instrument within its existing lending framework.

### 2.3 The Fund's financing framework seems fragmented and overly complex

The IMF's exceptional access framework is an example in case, as illustrated above. It reflects the difficulty of applying rather restrictive rules to accommodate a wide range of circumstances. Frequent "special cases" within the exceptional access framework have undermined the value of clarifying – to both members and markets – the conditions under which exceptional access would be provided. This has prompted criticism that the IMF's access policy and its decisions in crisis situations are unclear and unpredictable. In other words, there seems to be room for improving the quality, predictability and uniformity of the Fund's high access decisions.

Yet another example relates to the Fund's repurchase policy and, more particularly, its policy on time-based repurchase expectations. The decisions to extend repurchase expectations are indeed often presented, and viewed by market participants, as a de facto rescheduling of IMF credit. Confusion about what an extension of repurchase expectations really means leads to questions about the Fund's role in supporting members and to misperceptions regarding its policy of not rescheduling its claims, possibly eroding its preferred creditor status over time. In some cases, decisions on extensions could also be misperceived as signalling approval of a member's policies. Furthermore, the mere existence of two payment schedules – expectations and obligations – can be confusing. This confusion is compounded when a member has outstanding purchases both in the credit tranches and under the SRF, since the repurchase expectations policies are not identical for SRF and other GRA resources, as discussed earlier. Finally, implementation of the policy on time-based repurchase expectations has also raised questions about the appropriate benchmark against which to assess a member's balance of payments when an extension of repurchase expectations is requested, particularly in the case of follow-up arrangements.

The recent decision to establish yet another lending facility at the IMF, namely the SLF, adds to the complexity of the framework. Indeed, the financial assistance envisaged under the SLF could be provided under a traditional SBA, while adding the SLF to the Fund's lending facilities arsenal essentially divides countries into an A-list of nations

that qualify for the SLF without conditionality, and a B-list of other countries.

### 2.4 In sum ...

As a general conclusion, one could say that the IMF lacks a consistent and comprehensive financing framework. The whole structure of lending facilities and policies needs alignment in terms of eligibility criteria, access, pricing and maturities in order to raise the consistency, predictability and credibility of the lending framework. The relatively broad range of financial facilities, each targeted at very specific balance of payments needs and each governed by specific rules, risks being perceived as too complex by members and markets alike. Furthermore, while some have argued that the multitude of IMF facilities and policies acts as an institutional safeguard, one could argue that overregulation, as illustrated above, can lead to results that are just as arbitrary as those that may result from no regulation. Ill-conceived and over-detailed rules can prevent the IMF from doing justice in particular cases which the rules have not anticipated. All this could hamper the Fund in playing an effective signalling and catalytic role.

In order to address these issues, a comprehensive review of the IMF's lending structure is needed and seems especially timely now. First of all, such a review fits squarely within the Fund's ongoing Medium-Term Strategy, launched in 2005 and aimed at redirecting the role of the IMF amid the challenges of the 21st century. As regards lending, the Medium-Term Strategy recalled the changing circumstances and challenges of today's globalised economy, and its impact on IMF debtor members' financing needs.

Reflection is warranted on whether there is a gap in the Fund's lending structure that cannot be filled by using existing instruments. If it is concluded that there is a convincing case for creating new IMF financing instruments, due regard should be given to their interaction with the Fund's current financing framework in order to avoid a proliferation of lending instruments and any further inconsistencies.

Therefore, as it embarks on a review of its facilities, one of the issues the IMF needs to tackle is whether the present structure of facilities is unduly complex. Indeed, excessive complexity makes the Fund's operations more difficult for both its own members and the public to understand. A new lending framework would need to strike a balance between simplicity on the one hand and the right incentives on the other hand. In other words, it is important to recognise that there may be costs associated with a larger

number of facilities, especially in terms of complication and hence, a lack of transparency vis-à-vis both members and the public at large. At very least, therefore, when it considers setting up new facilities in the future, the IMF should first be satisfied that the problem to be addressed could not be dealt with equally well – or any better – through the existing facilities.

Finally, it should be noted that, in addition to discussions on new lending instruments, the Board is currently also reviewing the IMF's (exceptional) access policy and its overall policy on charges and maturities. In order to ensure consistency within the Fund's lending framework, these issues would also benefit from a thorough review of the Fund's lending structure. Indeed, a piecemeal approach that misses the global picture would risk creating further discrepancies, eroding – rather than enhancing – the reputation of the IMF's lending framework.

### 3. Towards a coherent lending framework for the IMF

Ideally, the IMF should have an integrated lending framework consisting of facilities and policies that are mutually aligned and consistently implemented. The question remains as to what such a framework should look like. Conceptually, there are three broad options, which are further elaborated below. Note that each of the suggested options is designed so as to prevent unduly large and prolonged use of the Fund's resources. This should

ensure that the monetary character of IMF financing and the revolving nature of its resources are preserved.

A schematic overview of each of the proposed options can be found in the table below.

#### 3.1 A multi-facility framework with one facility for each type of balance of payments need

One option would be to respond to each type of financing need with a different IMF financial facility. This means that there would be a different facility for normal short-term access, normal longer-term access, high short-term access and high longer-term access to the Fund's resources, for both members' actual and potential balance of payments needs. In fact, the Fund's current lending structure is built largely around this idea. The current facilities structure consists of a set of instruments whereby each facility is aimed at a different type of balance of payments need: the SBA for normal short- to medium-term access; the SRF for high short-term access (be it only for capital-account-driven crises); the EFF for normal medium- to long-term access cases; and *precautionary* Stand-By and Extended Arrangements for countries with no immediate balance of payments needs but some financial imbalances and risks to their balance of payments. The lack of explicit policies for longer-term and *precautionary* exceptional access reflects IMF members' divergent views on the desirability of granting exceptional access in these cases.

**TABLE 2** PROPOSED OPTIONS FOR A COHERENT LENDING FRAMEWORK FOR THE IMF

Options	Key characteristics
1. Multi-facility framework	<p>Broadly keep current framework (different facilities for different balance of payments needs), but adjustment of:</p> <ul style="list-style-type: none"> <li>• Exceptional access framework. Two options: <ul style="list-style-type: none"> <li>– minimum changes, introduce time-based surcharge for exceptional access under the SBA/EFF</li> <li>– abolish exceptional access framework, SRF for all exceptional access</li> </ul> </li> <li>• Repurchase policy</li> </ul>
2. Single flexible facility	<p>One SBA-type facility:</p> <ul style="list-style-type: none"> <li>• Flexibility in maturity with successive arrangements</li> <li>• One surcharge schedule: gradual, level-based <math>\leq 300</math>p.c. of quota; time-based <math>&gt; 300</math>p.c. of quota</li> </ul>
3. Dual framework, consisting of two facilities	<p>Two options:</p> <ul style="list-style-type: none"> <li>• One facility for short-term and one facility for medium- to long-term access;</li> </ul> <p>Or, alternatively</p> <ul style="list-style-type: none"> <li>• One facility for normal and one facility for exceptional access</li> </ul>

It is clear that, within this model, a specialised nonconcessional facility, designed to deal with specific contingencies or events, adds little value to the system. In this context, there might be a case for removing the CFF, the SLF<sup>(1)</sup> and the restriction on the use of the SRF for capital account crises only.

In light of the concerns raised in the previous section of this paper, there is also scope for aligning and refining the terms and conditions governing IMF lending. The fragmented nature of the current lending policies could actually create room for “arbitrage across facilities” and for concerns regarding the IMF’s credibility. Indeed, as the Fund’s lending policies often provide room for flexibility to accommodate individual members’ needs, some of its lending decisions have been perceived as arbitrary. This perception may harm the predictability and credibility of the Fund’s lending decisions and ultimately the perceived legitimacy of the institution.

Part of the problems with the Fund’s current financing structure relate to its exceptional access framework, as explained in the previous section. Indeed, the rules underpinning this framework provide less guidance and clarity in non-capital account crises than in capital account cases. Moreover, while short-term high access is provided under an SRF, which was specifically designed for such cases, medium-term exceptional access is provided under an “ordinary” Stand-By or Extended Arrangement. As indicated above, views nevertheless diverge on the need for an explicit policy on exceptional access in these cases for which the exceptional access framework and the SRF were not designed particularly.

Two options could be envisaged in dealing with these issues. The first would entail only minimum changes to the existing lending structure, while keeping the current distinction between capital and non-capital account crises in exceptional access decisions. As is currently the case, the four substantive criteria under the exceptional access framework would need to be met in the event of capital account crises, while for non-capital account cases, the criteria would only provide guidance, leaving the Board flexibility to grant exceptional access under the exceptional circumstances clause. In the same vein, the presumption that the SRF should be used for exceptional access in capital account crises, when conditions for its use apply, would also be preserved. Nevertheless, in order to remove the cost incentive for financing in the credit tranches or under the EFF above the access limits when the use of

shorter-maturity SRF resources would be more appropriate, the surcharges between these two sets of facilities need to be aligned. This could imply the introduction of a time-based surcharge under the SBA and the EFF for credit above the access limits, in line with the modalities of SRF financing. The resultant overall surcharge structure would ensure that a member pays more for exceptional access to the Fund’s resources and the longer these are used, under whatever facility they are granted.

Under a second option, one could consider more comprehensive changes to the Fund’s lending framework. A case could be made for abolishing the exceptional access framework. First, while the exceptional access framework was developed with capital account crises in mind, experience has demonstrated that members have equally needed exceptional access in non-capital account crises. Within this context, it might be reasonable to abolish the current distinction between capital and non-capital account cases. Second, in non-capital account cases, exceptional access has been provided where (several of) the four substantive criteria underpinning the exceptional access framework had not been explicitly met, illustrating the difficulty of applying rather restrictive rules to accommodate a wide range of circumstances. Instead of the current four specific exceptional access criteria, one could envisage the Fund granting exceptional access on the basis of the three criteria guiding all access to GRA financing. These criteria include (i) an actual or potential balance of payments need; (ii) the capacity to repay the Fund, including the strengths of the adjustment programme and (iii) a member’s outstanding use of IMF credit and record in the use of Fund resources.

One could argue, however, that applying “less restrictive criteria” could increase the number of cases potentially eligible for exceptional access, thus raising the risks the IMF faces in terms of potential credit concentration to large borrowers. To address this issue, under such a setting, the terms of the SRF should be used more broadly, i.e. in all cases involving exceptional access. The relatively high surcharges applied under the SRF, increasing with the time that IMF credit remains outstanding, should ensure that the Fund is not exposed to high levels of credit risk for an unduly long time. In order to accommodate more protracted high-access requirements, the maturity of the SRF might need to be adjusted accordingly. Again, the surcharges increasing with the length of time IMF credit remains outstanding should ensure that, in these cases too, unduly long use of the Fund’s resources is prevented. Note also that, if the SRF is used in all cases involving exceptional access to the Fund’s resources, precautionary high access under the SRF would also need to be formalised.

(1) The SLF Decision already incorporates a sunset clause, providing for the expiration of the facility two years after its establishment. At that time the Board can review experience with the facility and determine whether it should continue to exist and whether any design changes are warranted.

Finally, apart from the issues related to the IMF's exceptional access framework, problems regarding its current lending structure have also been observed within the context of its repurchase policy, as explained in section II. In order to address these issues, the practice concerning the Fund's decisions to extend time-based repurchase expectations and the associated publication requirements should be clarified and harmonised across facilities. Nevertheless, a case could also be made for simply abolishing the policy on time-based repurchase expectations. Indeed, Article V, Section 7(b) of the IMF's Articles of Agreement already states that a country must repurchase when its balance of payments need disappears. The effective implementation of this Article renders other repurchase incentives unnecessary. However, under such an approach, a system would need to be in place to encourage members to make voluntary advance repurchases. This could be achieved through adequate reporting to the Board or the publication of information regarding borrowing members' external positions in relation to their outstanding IMF loans. Alternatively (or additionally), a system could be considered involving a Board review of a country's balance of payments and reserve position, at regular intervals after the last drawing, in order to determine whether or not it should be expected to make an early repayment, and if so, at what pace.

### 3.2 A single flexible facility

At the other extreme, the Fund could opt for a single SBA-type facility that would be applied flexibly. This kind of system is appealing for its simplicity, transparency and because it avoids the difficulty of analysing *ex ante* the type and expected duration of the balance of payments need in question. In order to be workable and to ensure equal treatment, this approach would have to be based on clear rules. Such a system would nevertheless depend to a large extent on the Board's ability to take well-thought-out decisions based on clear principles governing the IMF's financial role and rigorous justification of every individual decision, with due regard to precedents and the merits and requirements of each case.

For a single facility (with a single maturity structure) to be able to address the issue of longer-than-expected financing needs, one could allow for consecutive arrangements. This would be a recognition of the fact that it is difficult to predict the duration of a member's balance of payments need in advance. Furthermore, it would increase countries' ownership of the adjustment programme and give the Fund more leverage in promoting members' adjustment efforts.

Second, a surcharge system, be it time- or level-based, or a combination of both, would need to be contemplated to prevent unduly long and large use of IMF resources. From a theoretical point of view, it could be argued that the rate of charge should not be used to discourage large use of Fund resources. The extent of IMF assistance should be based on the needs of a country: only large needs justify large use. It is the responsibility of the staff and the Board to verify if the amounts requested are in line with actual needs. This view pleads against the use of level-based surcharges and in favour of the sole use of time-based surcharges. This would add greatly to the transparency and simplicity of the surcharge structure. It would of course constitute a breach with current practice and might be conceived as too simplistic to capture the whole range of incentives and disincentives targeted by the current system.

The intuitively most appealing option, therefore, would be a combination of the two approaches. This kind of system would entail a matrix of charges associated with time and amount of resources outstanding. Though richest in its incentive structure, such a combined system may also be deemed too complex and not sufficiently transparent. Alternatively, a surcharge system combining the characteristics of the different graduation schedules that are currently in place, could be envisaged. Indeed, for credit outstanding above the cumulative limit of 300 p.c. of quota, there is a case for a surcharge system in line with that under the SRF. This implies the introduction of a time-based surcharge structure, providing incentives in support of the temporary use of exceptional access. Moreover, this time-based graduation would need to be applied across successive arrangements in one way or another. For credit outstanding below 300 p.c. of quota, a surcharge increasing with the level of IMF credit outstanding, aiming mainly at discouraging excessive use, might be preferred. Such a graduated surcharge starting at a relatively low level of credit would, moreover, allow for a gradual increase in the surcharge and thus reduce the discontinuities arising from one large step at 300 p.c. of quota.

### 3.3 A dual framework, consisting of two facilities

One could also opt for a dual-facility framework between the two more extreme options described above.

Such a framework could, for example, have a facility for short-term access (an "SBA-type" facility) and a facility for medium- to long-term access to the Fund's resources (an "EFF-type" facility), both also useable on a precautionary basis and for exceptional access to IMF finance. Such an approach could be justified on the basis of the

observation that there appears to be a tendency for countries' balance of payments needs to be either very short or rather long. Under such a framework, surcharges under the facility for medium- to long-term access would, for any level of credit outstanding, be higher than under the facility for short-term access. This should discourage unduly long use of the Fund's resources. To discourage unduly large use of IMF finance, the surcharge under both facilities would rise with the level of Fund credit outstanding.

Alternatively, the Fund could also opt for a framework consisting of a facility for normal access (an "SBA-type" facility) and a facility for exceptional access (an "SRF-type" facility), both of which could also be used on a *precautionary* basis. This approach could be justified on the basis of recent evidence that members' needs for IMF resources is expected to remain concentrated at the two ends of the access spectrum. It is indeed likely that GRA users' needs will either be primarily for signalling purposes (with low access) or for large access associated with a sudden deterioration in capital market conditions (where the need may be for exceptional access). Under this kind of framework, surcharges under the facility for exceptional access would be higher than under the facility for normal access, irrespective of the duration of outstanding IMF loans. This should discourage excessive use of IMF finance. To discourage unduly long use of the Fund's resources, the surcharge under both facilities would rise with the time of Fund credit outstanding.

## Conclusion

In an effort to adapt to changes in its environment, the IMF has over the years adjusted its lending framework. Lending facilities and policies have been created, abolished or modified, according to changing global circumstances. Nevertheless, these adaptations have often been made on an ad hoc basis.

This has given rise to some inconsistencies between the Fund's lending facilities. Some of its lending instruments even seem to have lost their relevance. The Fund's more specialised facilities in particular have either not (yet) been used or have been used much less than expected. The use of the EFF has declined as the Fund has been granting longer and successive SBAs. Other concerns are related to perceived gaps in the current lending structure. The SRF, for example, which was designed for members facing capital

account crises with short-term exceptional access needs, is ill-suited for members facing a capital account crisis with more protracted high access needs. Also, the IMF's exceptional access framework was designed for members facing a capital account crisis and has therefore provided less guidance in non-capital account cases. Moreover, some emerging markets have called for a lending instrument that would provide insurance against large and volatile capital flows, while middle-income countries are increasingly seeking sources of official financial support outside the IMF. Finally, the Fund's lending framework is often perceived as being too complex and fragmented (e.g. the exceptional access framework and the repurchase policy).

In order to address these issues, a comprehensive review of the IMF lending framework is direly needed. In fact, the Fund is currently reviewing its lending instruments and access policies in the context of its ongoing overall strategic review. This paper seeks to provide an input into this process and, within this context, suggests three options for modernising the Fund's lending structure. Under the first option, the spirit of the current multi-facility framework would be maintained, with a different facility for each type of financing need. In order to make this new multi-facility framework less complex and more internally consistent than the current set-up, a number of modifications are put forward to the policies governing it. More specifically, in order to better align the Fund's lending facilities and policies, the current exceptional access and repurchase policies would need to be adjusted at the very least.

A second option involves the most far-reaching adjustment of the Fund's lending framework, as it would replace the whole arsenal of IMF facilities with a single, flexible, SBA-type facility. Such a system is appealing for its simplicity, transparency and because it avoids the problem of having to analyse ex ante the type and expected duration of a member's balance of payments needs. On the other hand, in order to be workable and to ensure uniformity of treatment, each lending decision would need to be based on clear rules and with due regard to precedents and the merits and requirements of each case.

As an intermediary solution, the third option suggests replacing the current lending framework with a dual framework. Such a structure would comprise two facilities; one facility for short- and one for medium- to long-term access or, alternatively, one facility for normal access and one for exceptional access to IMF resources.



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