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The IMF's Lending Toolkit and the Global Financial Crisis

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The IMF's Lending Toolkit and the Global Financial Crisis

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ABBREVIATIONS

CCL	Contingent Credit Line
CFF	Compensatory Financing Facility
ECF	Extended Credit Facility
EFF	Extended Fund Facility
ENDA	Emergency Natural Disaster Assistance
EPCA	Emergency Post-Conflict Assistance
ESAF	Extended Structural Adjustment Facility
ESF	Exogenous Shocks Facility
FCL	Flexible Credit Line
GRA	General Resources Account
HAPA	High Access Precautionary Arrangement
HIPC	Heavily Indebted Poor Countries
LICs	low-income countries
PCL	Precautionary Credit Line
PLL	Precautionary and Liquidity Line
PRGF	Poverty Reduction and Growth Facility
PRGT	Poverty Reduction and Growth Trust
PSI	Policy Support Instrument
RAL	Reserve Augmentation Line
RCF	Rapid Credit Facility
RFI	Rapid Financing Instrument
SAF	Structural Adjustment Facility
SBA	Stand-By Arrangement
SCF	Standby Credit Facility
SDR	Special Drawing Right
SLF	Short-Term Liquidity Facility
SRF	Supplemental Reserve Facility

EXECUTIVE SUMMARY

The crisis prompted a significant revamping of the IMF's lending facilities. The terms and modalities of non-concessional facilities were adjusted to be more responsive to diverse country needs. Access limits were doubled, frontloading increased substantially, and conditionality was streamlined, including by the elimination of structural performance criteria. Facilities for concessional lending to low-income countries (LICs) were also streamlined and perceived gaps were eliminated.

Two new precautionary instruments were created: the Flexible Credit Line (FCL) and the Precautionary Credit Line (PCL), subsequently replaced by the Precautionary and Liquidity Line (PLL). The FCL is a precautionary instrument for countries with very strong policy track records and sound fundamentals but that are vulnerable to potential spillovers. The PLL is aimed at countries with sound policies that are, nevertheless, faced with remaining vulnerabilities, and may already need Fund resources. The intention behind these instruments was to make resources rapidly available, with high access limits and automaticity, and no or little ex post conditionality to assure markets about the good financial condition of the borrowing country. Current users of the FCL/PLL praised these new instruments pointing that they have served as a positive signaling device—an IMF's "seal of approval" of the country's policies—and that they largely mitigated the stigma of other IMF lending—facilitating the domestic discussion of economic policies—and providing confidence to markets in moments of stress. The launching of these facilities is also thought to have helped ease overall capital market conditions.

However, there are several unresolved issues with the new instruments: Only three FCL arrangements have been granted to date, due mainly to the rigorous qualification criteria, existing alternatives to IMF financing, and remaining stigma concerns. Potential access under these arrangements is large (at SDR 73.2 billion, it averages to 1,036 percent of the borrowers' quotas and represents 27 percent of total IMF's resources available for new lending), raising concerns about the Fund's ability to respond to further large requests for precautionary access without impinging on its crisis resolution capacity. Finally, none of the borrowers has so far wanted to exit from the arrangements.

Similarly, the PLL has been used by only one borrower. Some member countries indicated that the PLL may have increased the stigma associated with SBAs, raising questions on its role in the IMF's lending toolkit.

Progress has been made, but the IMF has not yet fully met the challenge of designing precautionary lending instruments to offer an insurance alternative to a large share of member countries.

I. INTRODUCTION

1. The global financial crisis prompted a significant revamping of the IMF's lending facilities. These facilities had already been under scrutiny in part as a consequence of the slump in IMF lending during the period of relative macroeconomic stability in the middle of the 2000 decade, but the crisis fueled the perception that a thorough overhaul of the lending toolkit was needed. In particular, it highlighted the urgency of adding a crisis prevention instrument to the traditional crisis resolution capability of the IMF.

2. The objectives of crisis resolution and crisis prevention have informed the Fund's financing role since the institution's creation.[1] Crisis resolution involves providing resources to help correct an already existing balance of payment problem, conditioned on the adoption and implementation of policies directed to the resolution of that problem. Crisis prevention, on the other hand, implies giving member countries certainty about the availability of sizable resources that can rapidly be called upon to cover eventual situations of stress, thereby preventing these situations from developing into full-blown crises. In either case, the cooperative nature of the institution—whose resources rely on quota contributions from member countries—necessitates the adoption of adequate safeguards for these resources.

3. The demands put on the IMF changed over time in line with the developments and transformations in the global financial system. Whereas in the early days Fund assistance was required mainly to help smooth the effects of short-term trade fluctuations, as time went by the growing liberalization of capital accounts—and the ensuing globalization of financial flows—as well as the needs arising from economic development and poverty reduction, and various specific shocks to the global financial system resulted in the need to widen the scope and change the emphasis of Fund activity.

4. The Fund adapted to these evolving circumstances, but the changes were for the most part inside the crisis resolution framework involving program conditionality and phased disbursements. The Stand-By Arrangement (SBA), established in 1952, developed into the main vehicle for assistance to middle-income countries while, since the late 1980s, the Structural Adjustment Facility (SAF), the Extended Structural Adjustment Facility (ESAF) and their successor the Poverty Reduction and Growth Facility (PRGF) became the primary vehicles to provide (concessional) assistance to low-income countries (LICs). Yet, the IMF struggled to establish a crisis prevention facility, and continues to struggle to this day. Some of the main facilities were allowed to be established as precautionary arrangements—i.e., arrangements that, in the absence of an immediate balance of payments need, were not supposed to be drawn upon but, nonetheless, provided for the availability of certain funds if

[1] Differing emphases on these objectives were already evident in the position of Keynes, who envisaged the IMF as somewhat akin to a lender of last resort with large resources automatically available in cases of need, and that of Harry White who advocated a smaller Fund that would lend on a discretionary basis subject to policy conditionality.

necessary. Also, several facilities were created with the explicit preventive aim of providing assurances to markets about the automatic availability of support to members, but neither of these initiatives has resulted in a satisfactory preventive instrument that garnered wide acceptance among the membership.

5. This paper documents the evolution of facilities at the IMF, focusing in particular on the changes implemented in the wake of the 2008 global financial crisis. Section II describes the facilities existing before the crisis and highlights some of the issues raised in their operation. Section III takes up the changes introduced in 2009 and discusses the underlying rationale and perceived goals of these changes. Subsequent adaptations made to these new facilities and those currently under consideration are discussed in Section IV. Section V assesses whether the intended objectives of the reforms have been achieved and concludes. Annex 1 provides a timeline of the different facilities.

II. Pre-Crisis

A. Non-Concessional Lending: The Early Facilities

6. Non-concessional financing—which is subject to the IMF's market-related interest rate (the "rate of charge")—is provided through the General Resource Account (GRA). GRA lending is subject to policy conditionality, safeguards and other requirements—such as access limits, phasing, and surcharges—that aim to preserve the revolving nature of the Fund's resources, and is structured as a temporary purchase of the currencies of other members in exchange for the borrowing member's own currency.[2] GRA resources can be *purchased* only when there is actual **balance of payments need**,[3] but they can be *committed* flexibly for both crisis prevention (in anticipation of an actual need) and crisis resolution.

7. During the early years of the Fund, **outright purchases** were the primary modality through which members made use of the Fund's resources. Requests for outright purchases were approved based on an assessment that the member's current and future policies would be sufficient to deal with its balance of payments problems and repaying the IMF. These continued to be used into the late 1960s.[4]

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[2] Members have unconditional access to the portion of their quotas that was paid in freely usable currencies or Special Drawing Rights (SDRs). Policy conditionality is looser for purchases in the "first credit tranche," equivalent to 25 percent of the member's quota.

[3] According to the IMF Articles of Agreements (Article V, Section 3(b)(ii)), a member's balance of payments need is a fundamental prerequisite for using IMF resources. See also IMF (1994b). For a discussion of the legal framework regarding this prerequisite, see IMF (2009a), p. 20.

[4] Thereafter, they were used mainly for assistance in the first credit tranche and for emergency assistance.

8. The **Stand-By Arrangement** (SBA)—which became and continues to be the main vehicle of IMF financing—was established in 1952 with the aim of providing assurances to member countries of unimpeded access to Fund assistance for as long as pre-agreed policy conditions were observed (i.e., conditionality). The motivation was to eliminate the uncertainty of having access to resources depend on the judgment of the IMF's Executive Board at the time of need. In a sense, this was a sort of pre-qualification by way of agreeing in advance to a set of policies, whose continued observance would guarantee access to Fund resources when needed. In practice, however, member countries came to request a SBA mainly after the fact, once the need had already materialized, and the SBA became essentially a crisis resolution instrument. Only decades later, when precautionary SBAs started to be used, some preventive features were restored.

9. Access to a SBA, as to all Fund financing, is agreed on the basis of present, prospective, or potential balance of payments need. The SBA allows an outright purchase of amounts available in the member's first credit tranche (the first 25 percent of its quota) upon approval of the arrangement, with the remaining funds phased in (usually) quarterly tranches subject to conditionality. The duration of a SBA is typically between 12 months and 18 months. There are limits on total access related to quota—unless lifted under the Exceptional Access Policy (EAP)[5]—and purchases are to be repaid in three to five years and carry a non-concessional rate of charge.

10. As time went by, the facilities toolkit was augmented in response to specific needs. The **Compensatory Financing Facility** (CFF) was created in 1963 to provide low-conditionality assistance for balance of payments needs caused by temporary and largely exogenous export shortfalls or (added later) excess costs of cereal imports. The amounts agreed under the CFF (up to 45 percent of quota) could be drawn outright.[6] The **Extended Fund Facility** (EFF) was established in 1974 to provide assistance to members with protracted balance of payments difficulties whose resolution required structural reforms that could not be accommodated in the shorter time frame of the SBA. The EFF typically involved a 3-year program with repayments spread out between 4½ years to 10 years.

[5] The Exceptional Access Policy framework defines the criteria that would need to be met to justify exceptional access. (See IMF (2004) and Section B below). Until 2009, normal access limits were 100 percent of quota annually and 300 percent of quota cumulatively. In 2009, these limits were doubled.

[6] The CFF was supplemented in 1969 with the Buffer Stock Facility designed to finance buffer stocks to stabilize prices of primary products. Another trade-related facility was the Trade Integration Mechanism (TIM) established in 2004. The TIM was activated only a few times in 2004–06 in order to deal with the termination of the World Trade Organization Agreement on Textiles and Clothing. Finally, in the early 1990s, there was a temporary facility, the Systemic Transformation Facility, that for two years helped countries in the shift from trading at non-market prices to market-based trade.

B. Exceptional Access and the SRF

11. Access to Fund resources is subject to limits but the Executive Board can waive such limits at its discretion if required by the circumstances of each case. Formal criteria for exceeding established access limits began to be formulated in 1981 and over time coalesced into the requirements that:

- There are exceptional balance of payments pressures resulting in a need for IMF financing that exceeds established limits;
- There is a high probability of public debt sustainability in the medium term;
- There are prospects of gaining or regaining access to private capital markets within the timeframe Fund resources are outstanding; and
- There is a policy program that provides a reasonably strong prospect of success.

12. Up to the mid-1990s, only a small proportion of Fund arrangements had had access above the limits. However, the continued expansion and integration of global financial markets increasingly exposed countries to reversals of capital flows and to crises that required assistance in amounts beyond those that could be provided under the IMF access limits. This was compounded by the slowness of adjustment of IMF quotas—upon which access amounts are defined—which tended to lag behind the growth of global output and trade (IMF, 2008a, p. 17). As lending beyond normal access limits increased, the IMF introduced a more complex array of charges and maturities to safeguard its resources and mitigate credit risk.

13. Against this background, in December 1997 and prompted by the needs put in evidence by the Asian crisis, the Executive Board established the **Supplemental Reserve Facility** (SRF).[7] This facility was intended to provide financial assistance to members experiencing exceptional balance of payments problems due to a sudden and disruptive loss of market confidence. The SRF was designed for members experiencing an actual crisis, and was not envisaged as a precautionary instrument to stem possible crises. It was conceived as a facility offering large scale resources—without specified access limits—on a short-term basis and with a significant surcharge over the basic rate of charge. The required underlying policy program was to be supported by a SBA (or EFF), under which it would be monitored and subject to conditionality.

[7] A proposal for a short-term credit line to assist members faced with very short-term balance of payments pressures had been discussed already in 1994, but the proposal failed to gain momentum (IMF, 1994a).

C. The Search for a Preventive Facility

14. At the same time that the IMF was adapting its financing facilities to cope with the larger needs arising from global and volatile capital flows, it was also searching for ways to help prevent the associated crises of confidence. **Precautionary arrangements**—full-fledged SBAs in which the member requesting the arrangement unilaterally commits, or declares the intention, not to draw on the resources immediately—begun to be used by some members. These arrangements had some preventive features—as they could be requested to address potential, not just actual, balance of payments needs—and could serve as a signaling device of accessibility to financing and of implementation of sound policies. However, they had the drawback that it was awkward for a member to request a financing arrangement, and bear the associated financial costs and political stigma, at times when no financing was really needed. Moreover, these precautionary arrangements still gave no assurances that such financing would be available when the need would actually arise, since the ability to draw depended on performance under the program.[8] Over the following years, there was only moderate use of precautionary SBAs.[9]

15. The fear that countries, especially emerging market economies, could face "severe capital market pressures less through flaws in their own policies than from 'contagion' emanating from elsewhere" (IMF, 1998, p. 1) led the Fund to consider a new contingent short-term line of credit for its toolkit. The new instrument was meant to provide sizable resources to countries already pursuing strong policies, but prone to sudden reversals of capital inflows that could materialize as a liquidity problem—rather than a solvency one—and result in an attack against their currencies. The expectation was that securing access to such a facility would increase the firepower available to fend off, and thereby help prevent, such an attack. The **Contingent Credit Line** (CCL) was approved in April 1998. Eligibility for this facility was defined by four criteria: (i) no expected need for Fund resources, unless activation was triggered by circumstances beyond the control of the member; (ii) a positive assessment of existing policies; (iii) good relations with private creditors; and (iv) Board approval of a satisfactory macroeconomic program, which the member would stand ready to adjust as needed. There was no general access limit, but it was expected that commitments would be in a range of 300–500 percent of quota.

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[8] Moreover, lags in data provision for assessing compliance with performance criteria could give rise to "blackout" periods limiting availability of financing (IMF, 2009a, p. 23).

[9] About one-fourth of the SBAs granted between January 1997 and October 2008 could be deemed to have been precautionary in nature. A "cumbersome exceptional access framework for lending above access limits and (…) a rigid conditionality framework" were reasons raised by staff for the low demand for precautionary SBAs (IMF, 2009a, pp. 22–23). Staff also highlighted that the SBA's "quarterly phasing and inherent on-off pattern for availability of financing" made it not ideal for crisis-prevention purposes (IMF, 2008a, p. 11).

16. In the event, the CCL found no takers and was allowed to expire in 2003. The main reasons for the lack of interest in the facility appear to have been the strict eligibility criteria—which limited potential use to a narrow set of members with strong fundamentals; the signal of weakness attached to a request for a CCL (the so called "first mover" problem); and the concern about the very negative signal that would be conveyed if a country were to lose eligibility for, or access under, the facility (see IMF, 2003).

D. Concessional Financing Instruments

17. The IMF's first incursion into concessional lending took place in 1975 with the establishment of the **Oil Facility** subsidy account to provide temporary balance of payments financing to members adversely affected by higher oil prices. The rate of charge on this financing was 2 percent and the required loan resources were provided by several oil producing countries, with subsidies being contributed by industrial and oil producing countries. The following year a **Trust Fund** was set up to provide concessional financing to low-income members. Resources for the Trust Fund were obtained through the sale of part of the Fund's gold holdings. Loans out of the Trust Fund were repayable in 10 years—with 5½ years grace period—and carried an interest rate of 0.5 percent.

18. The **Structural Adjustment Facility (SAF)** was established in 1986 to provide concessional assistance to LICs that faced balance of payments problems stemming from structural weaknesses. The SAF was financed by reflows of Trust Fund loans and carried the same terms as the Trust Fund, but included conditionality defined in the context of policy framework papers prepared jointly with the World Bank. Conditionality was strengthened in the context of the **Enhanced Structural Adjustment Facility (ESAF)** established in 1987, which offered higher access under three-year arrangements.[10] Resources for ESAF loans and subsidies were provided mostly by member countries and administered by the Fund, as trustee of the ESAF Trust.[11] The expiration date of both the SAF and ESAF was repeatedly extended while the Trust was enlarged with new loan and subsidy contributions in 1994.

19. In 1996, as LICs confronted the consequences of large and unsustainable levels of external debt, low growth, and widespread poverty, the IMF and the World Bank launched the **Heavily Indebted Poor Countries (HIPC) Initiative** aimed at alleviating the debt burden of LICs. The IMF provided debt relief under HIPC through grants that reduced countries' debt obligations to the Fund. This relief was augmented in 1999 at the time when

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[10] The SAF continued to operate concurrently with the ESAF, but the expectation was that "most members will find it preferable to request arrangements under the ESAF rather than the existing SAF, and management and staff would recommend such an approach" (IMF, 1987, p. 3).

[11] After extensive debate, it was agreed that the trust arrangement—whereby loan resources are provided by bilateral creditors, while subsidy grants are provided by member countries and the Fund itself—was the preferred mechanism to finance the Fund's concessional lending.

ESAF was transformed into the **Poverty Reduction and Growth Facility (PRGF)**, which was directed at reducing poverty and promoting growth on the basis of country-owned poverty reduction strategies. Successful implementation of a program supported by the PRGF (or EFF) was required to access HIPC relief.

20. At the start of the new century, and with the aim of contributing to the achievement of the Millennium Development Goals, the IMF embarked in a broad revision and adaptation of its support for LICs. By then the HIPC and PRGF processes were succeeding in building a stronger macroeconomic foundation for higher growth rates (IMF, 2012b). Thus, there was a need to shift focus towards microeconomic and supply-side fundamentals where many of the required policy reforms fell outside the Fund's core areas of competence. This triggered discussion on both the need to be more selective about the circumstances in which country programs were to be established and the need to strengthen cooperation with the World Bank. The relative scarcity of concessional resources also indicated the desirability of **blending** concessional and GRA resources in certain cases.[12]

21. With the PRGF remaining at the center of the IMF's lending to LICs, the Fund's financing role in these countries was focused on the provision of temporary financial assistance in support of macroeconomic reform efforts, on the policy response required when countries are confronted with emergencies arising from exogenous shocks, and on strengthening institutions and policies that underpin sound macroeconomic management. Moreover, IMF financing continued to play an important role as a signaling and catalytic device for LICs.[13] In the case of LICs with limited or no balance of payment need, **low-access PRGF** arrangements, with a possibility of quick augmentation in case of need, came to be used as both signaling and preventive instruments. The debate on the IMF's role in LICs was also unavoidably affected by the tension between the need for sustained engagement—given the protracted nature of the problems faced by LICs—and the desire to avoid prolonged use of Fund resources and move countries to a relationship based on Article IV surveillance and technical assistance.

22. IMF emergency assistance, other than the cases covered by the CFF, had been provided since 1962 in the form of regular, non-concessional outright purchases expected not to exceed one credit tranche (25 percent of quota) except in special circumstances. Guidelines on the provision of emergency assistance for **natural disasters** (ENDA) were established in 1982, and expanded in 1995 to include countries in **post-conflict** (EPCA) situations that prevented them from formulating and implementing a program that could be supported by a regular facility. By 1999, limits on access were increased and efforts were

[12] The degree of blending takes into account the International Development Association (IDA) operational cutoff, the country's ability to access markets, and the risk of debt distress.

[13] A catalytic effect of IMF lending refers to its ability to increase the willingness of private investors to lend or of donors to provide resources to the concerned country. See de Resende (2007).

made to provide interest subsidies on a case-by-case basis, but there still was no support at the Executive Board for the creation of specific facilities to deal with disasters or post-conflict situations.

23. A further issue was the desire "to address the needs of LICs that may not need, or want, Fund financial assistance, but still want the Fund to support, monitor, and endorse their policies" (IMF, 2005). This resulted in the creation of the **Policy Support Instrument** (PSI) in 2005, which was to assist countries in the design of macroeconomic policies and provide signals to donors and creditors of IMF approved and monitored policies, but without any financing. The PSI was intended exclusively for LICs and was to serve as a complement, not a substitute, for PRGF financing. Policies included in a PSI would need to meet the standard of upper credit tranche conditionality and would be subject to reviews conducted on a regular basis. The PSI, which provided a basis for quick agreement on a PRGF program in case of sudden need, was considered (together with the low-access PRGF) as a preventive instrument for LICs.

24. Together with establishing the PSI, the Board agreed to create a specific emergency assistance facility within the PRGF Trust: the **Exogenous Shocks Facility (**ESF). The ESF was to provide concessional financing to PRGF-eligible member countries experiencing an exogenous shock but not having a PRGF arrangement in place (countries that already had an arrangement could deal with a shock by requesting an augmentation). The ESF interest rate and repayment terms were the same as those for the PRGF but, reflecting the shock-induced nature of the need, the length of the arrangement was shorter and the emphasis on structural reforms lower than under a PRGF arrangement. Also, the ESF was deemed to be distinct from emergency assistance (ENDA and EPCA), as its concessional terms were even more favorable and involved a program carrying upper credit tranche conditionality.

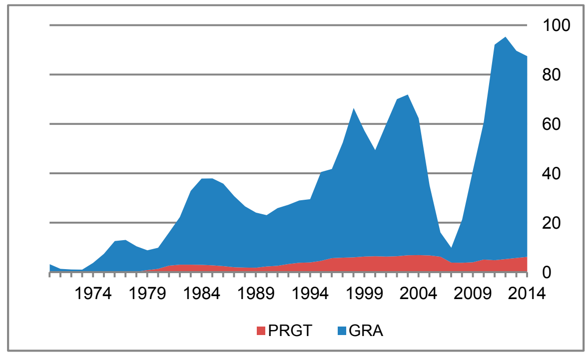
25. The ESF found no takers in the early years of its existence and in 2008 the IMF modified it in order to provide assistance more quickly and with more streamlined conditionality. The darkening global economic environment and surging food and fuel prices prompted the move to reform the facility. The new ESF included two components: (i) a **rapid-access** component under which up to 25 percent of quota was provided in a single outright purchase, subject only to understandings (not a negotiated program) on appropriate policies to deal with the shock; and (ii) a **high-access** component which could provide up to an additional 75 percent of quota on the basis of a one-to-two year upper credit tranche-quality economic program. Either component could be used concurrently with other Fund facilities or instruments.

III. The Crisis and the Reforms

A. Antecedents to the 2009 Reforms

26. After the CCL was discontinued, and at a time when IMF lending was at its lowest during the three-year period that preceded the 2008–09 financial crisis (Figure 1), there was active discussion at the Fund regarding options for retooling the lending framework. For some among staff and Executive Directors, there was a feeling that the Fund's pool of resources "[had] become too small for its lending to be relevant to a large segment of the membership," and that its lending instruments "[did] not provide the service that members seek," sent "negative signals," and "[came] with too many conditions, too little financing and [were] too costly" (IMF, 2008a, p. 6).

Figure 1. IMF Credit Outstanding
(In billions of SDRs)



Source: IMF Finance Department.

27. For many, the low demand for IMF lending was not a problem per se, since the crisis resolution capability of the Fund remained unchallenged, and it was likely just a consequence of the relative benign global economic situation. Others, however, pointed to several developments that were undermining the role of the Fund —such as the rise of regional reserve pooling arrangements (e.g., the Chiang Mai Initiative), the growing trend of countries to self-insure through building up reserves, or the reliance on bilateral swap lines between central banks—and called for a thorough rethink of the Fund's financing role. The nature of the more recent crises, shifting from current to capital account crises, was also a reason for reforming the toolkit either in the form of "a credit line designed to help forestall capital account shocks" (IMF, 2008a, p. 11) or to address the notion that with the existing toolkit "disbursements were phased and fell far short of measures of potential capital outflows" (IMF, 2009a, p. 15).

28. A number of considerations influenced the extensive discussions on the design of new lending facilities. Such discussions prepared the ground for the relative rapid launching of new facilities in 2009. Among these:

(a) ***Predictability of access versus safeguarding the Fund's resources.*** Member countries needed certainty that funds would be available to them when there was a need. This would require automatic access to IMF resources without the uncertainty of having these resources dependent on the judgment of the Executive Board. At the same time, its Articles of Agreement require the IMF to safeguard its resources and ensure that they are directed to the correction of balance of payments maladjustments, thus Board involvement and monitoring is required.

(b) ***Conditionality.*** Most Fund lending is subject to conditionality in order to ensure the implementation of measures directed to the appropriate resolution of balance of payments problems and to put the country in a position to repay. Conditionality also provides members with clear markers about what is needed for a program to remain on track and maintain the ability to draw. However, there was a fear that the IMF was overdoing conditionality, which was often seen as heavy handed, undermining ownership and, in the extreme, interfering with sovereignty. The Fund on several occasions rewrote its conditionality guidelines to ensure that it was applied judiciously, trying to constrain the introduction of conditions that, although desirable, were not critical to the objectives of programs. Despite these efforts, conditionality continued to be a deterrent for members to approach the IMF. Thus, the extent to which conditionality would be required became an important element in the discussion of new facilities.[14]

(c) ***Qualification.*** Safeguards could involve "ex ante" or "ex post" conditionality. With ex ante safeguards, a member that qualifies would gain automatic access (for as long as it remains qualified), but the qualification criteria would need to be stringent enough to effectively mitigate risks to Fund's resources, limiting the number of countries able to use such a facility. Moreover, those that qualify would face problems in case they fail to maintain qualification. Safegards based on ex post conditionality relate access to the implementation of agreed policies subject to monitoring, which could make the instrument available to a wider group of countries, although at a loss of automaticity.

(d) ***Signaling.*** Qualifying for a Fund arrangement was expected to send the signal that the country is, or is committed to, following sound policies. Thus, there would be an incentive for some countries to enter into an arrangement with the Fund just to benefit from such signaling. The IMF's longstanding approach was to assess qualification when the member requests access to resources. However, periodically the idea surfaced that such assessments should be done and made public automatically, thereby mitigating the potential for negative entry signals (stigma) associated with a request for an arrangement. This idea did not prevail because of the IMF's unwillingness of having its surveillance work acquire the trappings of a rating agency.

(e) ***Stigma.*** Thought to be a major factor in deterring or retarding the decision of member countries to approach the IMF, stigma may exist under any facility. There are two aspects to stigma: one is the political cost associated with negative perceptions about past experiences

[14] For instance, one idea discussed prior to the reforms was that there should be less conditionality when the required access is low, when the underlying shock is exogenous (i.e., not from self-inflicted problems) and self-correcting, or the policy stance is strong and credible.

with the IMF (political stigma), the other relates to the concern that markets will see an approach to the Fund as a signal of weakness (signaling stigma). This latter concern plays a crucial role in the design of preventive facilities, which require approaching the IMF when there is no actual need for resources. The experience with the CCL highlighted the importance of de-stigmatizing any preventive facility by having one or more relevant countries successfully use it (to mitigate the first mover issue).

(f) ***Moral hazard.*** Considerations of moral hazard were particularly present in discussions about exceptional access or preventive facilities. The prospect of access to IMF lending may lead private creditors to under-price lending risk, especially in cases where the systemic and political importance of a member means that its economy is perceived as "too big to fail." There had also been concerns about reckless behavior of borrowers underpinned by IMF financing, but it was felt that program monitoring plus the high cost of a crisis would make such behavior unlikely.

(g) ***Financial terms***. Financial terms need to support the revolving nature of Fund resources by limiting the demand for a facility, reinforce safeguards, and help ensure an appropriate remuneration to Fund financing, without being overly onerous to the requesting member country.

29. The considerations above informed the search for a new vehicle that would provide high-access financing for crisis prevention. The ensuing debate centered on a vehicle tentatively named the **Reserve Augmentation Line** (RAL) which was to target "emerging market countries that have strong macroeconomic policies, sustainable debt, and transparent reporting and that are making progress in addressing remaining vulnerabilities to shocks" (IMF, 2006a, p. 1). It should be noted that, at the time, the possibility of a crisis hitting advanced economies was not part of the discussion. By 2006, in an Executive Board seminar on these issues, Directors took note of "the interest of emerging market members and others in an instrument that could serve as a signaling and commitment device for strong policies, while assuring large scale financing if needed." At the same time, however, and with the experience of the CCL still fresh in their minds, they recognized that "demand for a liquidity instrument may be constrained in today's relatively benign market environment" (IMF, 2006b). Outreach with official sector and market participants revealed some support from the official side, but mixed views from market representatives, who appreciated the commitment and signaling framework of the proposed instrument but "worried that a new liquidity instrument could, in a period of already abundant liquidity and narrow spreads, lead to undue further compression of spreads and overborrowing" (IMF, 2007, p. 6). Other market representatives, however, thought that the mooted access limit of 300 percent of quota was too low and stressed that automaticity of access was crucial.

30. The qualification criteria proposed for the RAL were: (i) no immediate need to use Fund resources (if there were such a need a SBA would be more appropriate); (ii) good policies in place as described in an economic and financial program prepared by the country;

(iii) sustainable debt; and (iv) transparency in the reporting of economic data. Upon qualification, a member would have automatic access to large financing, although views varied in this regard between 300 percent or 500 percent of quota. Directors thought that a strong qualification framework would limit the use of the RAL to countries with sound fundamentals, and noted further that frontloaded access under the RAL would be justified by the strength of the member's economic position at the time of approval and the credibility of its commitments.

31. In the end, the long debate on the RAL was unable to yield a design that could strike the right balance between being attractive to potential users and providing adequate safeguards to the Fund. By 2008, broad agreement had been reached on many important design features, yet progress on the RAL was still delayed by concerns over some design tradeoffs, the first mover problem, and the fear of creating an instrument that would go unused. In the more than two years since the facility was first mooted, there was no clear indication of demand from potential users.

32. By 2008, when the global financial crisis struck, "…it exposed gaps in the Fund's lending toolkit." The Fund responded rapidly to assist members with immediate financing needs, but its ability to mount a preventative and systemic response was hampered by the inadequacy of its precautionary lending instruments and a resource base that had not kept up with the rapid increase in global trade and capital flows" (IMF, 2010a, p. 5). The issues discussed above, that had been part of the debate on the RAL, now laid the groundwork for the discussions on the major reform of the non-concessional lending toolkit that was approved in March 2009. Underpinning this discussion was an acknowledgement that "as members strengthen their policies and gain deeper and more secure market access, their need for traditional, phased adjustment-based balance of payments support declines, while their need for support to maintain confidence, and cope with shocks, risks, and vulnerabilities rises"(IMF, 2008a, p. 3).[15]

B. The 2009 Reforms

33. Against this background the Fund set out to overhaul its lending toolkit and to establish a new crisis prevention instrument. There was broad agreement on several, mostly complementary, objectives that the reforms would seek to attain, including (a) increase the attractiveness of IMF lending; (b) streamline the lending toolkit; (c) address gaps in the

[15] A supplement (IMF, 2008b) describes two further proposals considered in the debate but that failed to be accepted: The Financial Stability Line (FSL), a contingent instrument to protect against financial disturbances in countries opening up their capital market and/or strengthening regulatory and supervisory frameworks, and the Rapid Liquidity Line (RLL) for countries with sound policies and fundamentals that are already hit by turbulence in global capital markets. The limited access under the FSL and its short time horizon (up to two years) were judged insufficient to cope with capital crises and contributed to its unattractiveness. As for the RLL, the frequent monitoring (shorter than half-yearly) was the main unattractive feature.

toolkit, in particular in regard to a crisis prevention instrument; and (d) update and increase the relevance of the PRGF facilities.

(a) Increase the attractiveness of IMF financing

34. **Reforms to the GRA and conditionality frameworks** were introduced "to ensure that the Fund is well-equipped to fully meet the needs of its membership" and reduce the intrusiveness of conditionality (IMF, 2009e). The main reforms were:

- Doubling normal GRA access limits to 200 percent of quota annually and 600 percent cumulatively, net of scheduled repurchases. Higher access arrangements would continue to be approved under the EAP criteria.
- Structural performance criteria, which were perceived as reducing national ownership while being difficult to define objectively, were eliminated and replaced by a review-based approach to monitoring implementation of structural reforms. This applied to all Fund arrangements, whether financed by GRA or concessional resources. Moreover, conditionality overall—particularly in the fiscal area—was relaxed wherever possible to provide some countercyclical stimulus to counteract the effects of the crisis (Reichmann, 2013).
- In recognition of member's varying circumstances, GRA arrangements could be designed flexibly in respect to aspects such as phasing, frontloading of access, and frequency of performance criteria test dates and Board reviews.
- The structure of charges was simplified.

(b) Streamline the lending toolkit

35. The SRF and the CFF were eliminated, as they were less attractive than alternative facilities and were rarely used or not at all. There was also discussion on eliminating the EFF (IMF, 2009d),[16] but in the end the EFF was retained mainly to be used as a blend with PRGF-ESF Trust resources for LICs graduating from low-income status.

(c) Address gaps and establish a crisis prevention instrument

36. While the SBA (also in its precautionary guise) was to remain the appropriate instrument for many members with short-or medium-term balance of payments needs, it "should not be a straitjacket that prevents the Fund from tailoring its services better to members' circumstances and demands" (IMF, 2008a, p. 3). Stakeholders felt that the missing

[16] At that time, staff argued that the kind of financing provided under the EFF was no longer needed and that increasing access to capital markets by emerging market economies (notwithstanding the crisis) explained the lack of use of stand-alone EFF arrangements since 2002 (IMF, 2009a). This view was not endorsed by the Board.

elements in the lending toolkit were (i) a pure signaling and monitoring instrument, (ii) a short term liquidity instrument, and (iii) a crisis prevention instrument.[17]

37. A **pure signaling** instrument for emerging market countries, with no financial backing and modeled on the PSI, was debated but it did not garner sufficient interest. Middle-income members could continue to resort to low-access precautionary SBAs for signaling purposes.[18]

38. A **Short-Term Liquidity Facility** (SLF) was approved in October 2008. This facility was designed to help members with strong fundamentals and policies, that nonetheless could face short-term, and potentially self-correcting, balance of payments difficulties arising from external market developments. Thus, this facility was intended to prevent incipient liquidity problems from becoming insolvency crises. The temporary nature of the balance of payments problem and the high qualification threshold would be the key safeguards for the IMF. The Executive Board's decision "aimed at enhancing the Fund's ability to mitigate the effects of the crises like the one currently gripping the global economy and to restore confidence in member countries" (IMF, 2008c). Access under the SLF was to be up to 500 percent of quota and in the form of outright purchases, which had to be repaid after three months. Given the qualification and access requirements, the facility found no immediate users and was subsumed into the major reform of the lending toolkit that was to follow a few months later.[19]

39. In March 2009 the IMF launched the **Flexible Credit Line** (FCL). The FCL was designed to make resources available with high automaticity to countries with very strong track record of policy implementation and sound fundamentals. The main objective was to provide assurances to qualifying members of rapid and upfront access to resources with no ex post conditionality. Access to the FCL is based on rigorous qualification criteria (ex ante conditionality) intended to provide confidence that the member would take appropriate corrective action when faced with destabilizing shocks. The FCL is available to address all types of balance of payments needs and could be used for either contingent or actual financing. As staff indicated, "the FCL could also help high performing members deal with financing pressures from the ongoing global deleveraging" (IMF, 2009a, p. 28).

40. To retain flexibility in dealing with most shocks, access was left uncapped, although it was expected that it would not exceed 1000 percent of quota (IMF, 2009c, p. 9). Given the

[17] The concept of a "quiet" facility was also discussed but it failed to gain any traction. Under this proposal Fund financing would be provided with little public information, aiming to mitigate stigma issues or adverse market reactions, but this clearly ran against the Fund's policies of transparency.

[18] When the intention was primarily signaling, middle-income IMF members could resort to a precautionary SBA with the lowest possible access that still gives a credible signal (i.e., above the first credit tranche to allow upper-credit tranche conditionality), while minimizing the commitment fee (IMF, 2008a, p. 11).

[19] Interviews with authorities from countries that currently use precautionary IMF lending, indicated that the access limits had been judged to be insufficient for the needs of countries that qualified for this facility. In any case, the short existence of the SLF makes an assessment of the causes for its demise difficult.

FCL's rigorous qualification requirements, it was not to be subject to the exceptional access framework. Members could choose—at the time of requesting the arrangement—between a six-month arrangement or a one-year arrangement with a mid-term review (both of which could be renewed).[20] The entire amount of approved access was made available upfront and the member had the option of drawing this amount in one or multiple purchases during the arrangement period. The FCL was subjected to the same charges, surcharges and repurchase periods[21] of all other lending in the credit tranches.

41. At the time they approved the FCL, Executive Directors stressed that the assessment of a member's qualification should be undertaken confidentially and only at the request of the member.[22] Emphasizing transparency, Directors agreed that the Managing Director should generally not recommend approval of a request to use the FCL unless the member had consented to publication upon approval of the associated Board papers. A number of Directors raised the concern that the FCL could induce large precautionary use of Fund resources, crowding out lending for crisis resolution. In response to this concern it was agreed that the instrument would be reviewed after two years or when commitments under it reached SDR 100 billion (IMF, 2009e).[23] One of the risks of designing the FCL to serve just strong performers was that this could increase the signaling stigma associated with a request for a precautionary SBA by members unable to qualify for the FCL. Indeed, although any approach to the Fund for an FCL would be handled confidentially, the mere fact that a country had actually requested a SBA would send the signal that the country had not been able to meet the qualification requirements of the FCL. Therefore, a key objective of the reform was to clarify the framework governing precautionary SBAs to ensure that all members also had access to an effective crisis prevention instrument. This required making **high-access precautionary SBAs** (HAPAs) available on a more regular basis.[24] The known drawbacks of precautionary SBAs, e.g., the need to negotiate a program with the IMF or the uncertainty created by having access to resources at a time of actual need subject to a decision by the Executive Board,

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[20] From a safeguards point of view, providing a commitment to make resources available without review becomes riskier as the term of an arrangement becomes longer, given that the circumstances of the member may change over time. On the other hand, a review increases the exit risk, if such a review were not to be successful.

[21] Credit tranche purchases have a 3¼ to 5-year repurchase period and there is an expectation that members will repay the Fund as soon as their balance of payments and reserve position improve. In the case of the FCL, members were thought likely to seek early repayment in order to benefit from the positive signaling effect this would provide. As discussed below, however, timely exit from these arrangements appears problematic in practice and, given perceived remaining risks, none of the FCL users to date have yet exited from the facility after more than five years since its inception.

[22] This is not a "quiet" instrument, though. Only the qualification discussions are restricted to the public. Once the program is approved, full public disclosure is provided.

[23] By the end of the first quarter of 2014, SDR 73.2 billion were committed under the FCL.

[24] Up to the time of the reform, use of HAPAs had been limited to Uruguay (2002), Brazil (2003) and, shortly before the reform, El Salvador (2009).

could not be eliminated; but it was deemed that enough flexibility to reduce their impact had been introduced with the reforms of the GRA and conditionality frameworks mentioned above. Indeed, there were some who believed that HAPAs would be sufficient for the entire membership, obviating the need for the FCL and for making difficult judgments on the strength of policies, fundamentals and track record of a member.

(a) Reforms of PRGF facilities

42. The financial crisis as well as food and fuel price shocks in 2008 affected LICs and prompted a reexamination of IMF concessional facilities. At the time it was noted that "…the Fund's toolkit for LICs will need to become more flexible in light of increasingly diverse country needs and heightened exposure to global volatility, including during the current global crisis" (IMF, 2009b, p. 4). In presenting the case for reform, IMF staff drew attention to "three notable gaps in the Fund's concessional toolkit: (i) flexible short-term financing; (ii) a precautionary instrument; and (iii) flexible emergency financing." In the first case, LICs facing short-term financing needs caused by domestic factors such as policy slippages or confidence/banking problems still needed to rely on non-concessional SBAs for their resolution. In the second, as more LICs gained market access and became exposed to global turmoil the lack of a concessional preventive facility was becoming increasingly evident. And in the third, emergency financing, given the piecemeal approach to the establishment of the different facilities, was limited only to conflicts, natural disasters or exogenous shocks, excluding other possible sources of emergency.

43. A new architecture of facilities for LICs was established in July 2009. All concessional facilities were put under the umbrella of a single **Poverty Reduction and Growth Trust** (PRGT) unifying thereby their terms and financing conditions. The toolkit was streamlined to include three concessional facilities and one non-financial instrument:

- The PRGF was relabeled as the **Extended Credit Facility** (ECF) and continued to be the Fund's main tool for providing medium-term support to LICs with protracted balance of payments problems. The three-year ECF arrangements were to support upper-credit-tranche quality economic programs.
- The **Stand-by Credit Facility** (SCF) was to provide financing to LICs with short-term balance of payments needs (similar to the SBA but on concessional terms). These needs included those caused by exogenous shocks (superseding the high access component of the ESF). As with the SBA, **the SCF could be also approved on a precautionary basis.**
- The **Rapid Credit Facility** (RCF) was to offer rapid low-access financing with limited conditionality to meet urgent balance of payments needs. This financing was to be provided as outright purchases, based just on ex ante understandings on policy. Rapid assistance was indicated for cases where upper tranche conditionality was either not needed, because of the transitory nature of the need, or not feasible, if

policy capacity was constrained. The RCF replaced ENDA, EPCA and the rapid access component of the ESF.

- The PSI remained as a signaling device and a non-financial support tool able to facilitate access to the SCF or RCF, if needed.

44. Also in July 2009, the Board endorsed a LIC financing package that more than doubled the Fund's concessional lending capacity to SDR 11.3 billion. Most of the additional subsidy resources were mobilized from the Fund's internal resources, including from gold sales, but they also included new bilateral contributions. The new resources enabled the doubling of the access limits for concessional facilities that had been approved in April that year.[25] Access was available up to 100 percent of quota per year and 300 percent cumulatively, and rules for blending with GRA resources in the case of the better-off LICs were strengthened. The interest rates on concessional facilities were to be adjusted every two years to limit fluctuations in concessionality and subsidy costs in light of changing global interest rates. In addition, **exceptional interest relief**—zero percent interest on all outstanding concessional credit—was adopted to assist LICs during the crisis. The exceptional interest relief has been extended twice and continues now through end–2014.

45. Together with prompting the revamping of concessional facilities, the food/fuel and global crises led to an increasingly accommodating design of LIC programs aimed at providing policy space in the face of these crises. Inflation targets were revised upward to accommodate rising world prices while current account deficits were allowed to widen. Most programs incorporated fiscal easing during 2007–09, including increased levels of spending. Structural conditionality was streamlined.[26]

IV. Further Reforms and Adaptations

46. Concerns about the adequacy of the Fund's lending toolkit did not end with the 2009 reforms. Already by October that year the IMFC Communiqué stated that "We ask the Fund, by the time of the next Annual Meetings, to study and report on the future financing role of the Fund. Building on the success of the FCL and high access precautionary arrangements, this study should consider whether there is a need for enhancing financing instruments and whether this can offer credible alternatives to self-insurance, while preserving adequate safeguards" (IMF, 2009g, p. 5).

47. Moreover, even though the reforms had been followed by a G-20 proposal to treble the Fund's lending resources, doubts remained whether the measures had actually been

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[25] In addition, the SDR allocations agreed during the height of the crisis provided about SDR 13.5 billion to bolster LICs' foreign exchange reserves.

[26] See IMF (2012a) for a review of these reforms.

effective and whether demand for the new facilities would be sustained over time. In this context also, the EAP's requirement of high probability of debt sustainability needed to be relaxed in order to allow lending to countries that posed risks of systemic spillovers.[27]

A. Enhancement of the New Facilities

48. The SBA remained at the center of the Fund's financial activity. Nineteen SBAs were approved between the September 2008 collapse of Lehman Brothers and March 2010, when the discussion on Fund facilities was reopened. Moreover, the expectation was that, as a consequence of the ongoing crisis, a return of balance of payments problems rooted in fiscal difficulties was likely to keep the SBA in its central position. At the same time, the spreading of the crisis to the Euro area brought arrangements under the EFF back as a vehicle for large-scale financing to confront protracted structural problems in the crisis countries. Three EFFs of around SDR 20 billion each—and more than 2000 percent of quota in each case—were approved for Ireland, Greece, and Portugal during 2010–12.[28] Beginning in 2009, precautionary resources were approved under three HAPAs (Costa Rica, El Salvador, and Guatemala) and three FCL arrangements (Colombia, Mexico, and Poland) (Figure 2).

49. Each of the three FCL arrangements approved—for Mexico (SDR 31.5 billion), Poland (SDR 13.7 billion), and Colombia (SDR 7 billion)—had three successor arrangements approved, with their terms extended to two years.[29] As intended at the time they were approved, countries have not drawn on these facilities.

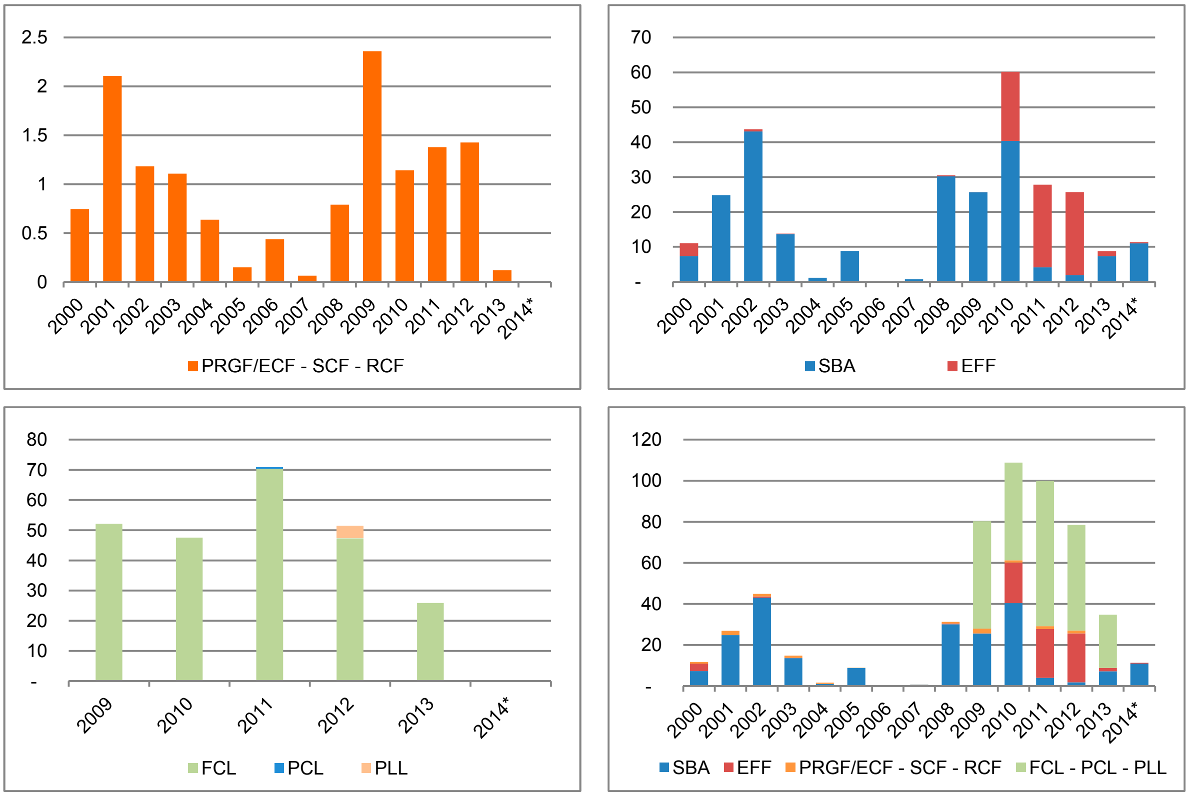
50. By early 2010, when discussions on the lending toolkit resumed, the key questions as regards the FCL were how effective it had been in strengthening market confidence in these countries and, in a wider sense, whether this new instrument could remain without modification as an established component of the lending toolkit. No further FCL had been approved in 2009 or early 2010; and as the crisis shifted focus towards the periphery of the euro area, the drying out of demand for the new IMF precautionary instruments, together with lingering memories of the difficulties faced in attracting the three cases that had obtained a FCL, gave pause to the early optimism and prompted a search for new, or enhanced, crisis prevention instruments.

[27] As of June 2014, there is an ongoing debate at the IMF about whether such relaxation should continue or be eliminated.

[28] These very high levels of access could be accommodated under the Exceptional Access Policy, even though an exception clause needed to be introduced in the policy's requirement about debt sustainability.

[29] The arrangements for Mexico and Poland were augmented and currently stand at SDR 47 billion and SDR 22 billion, respectively, while the Colombian arrangement was scaled down and is now at SDR 3.9 billion.

Figure 2. Commitments Under Fund Facilities
(In billions of SDRs)



Source: SPR Database on Fund Arrangements; IMF's Finance Department (FIN).
* Data available as of May 12, 2014.

51. The lack of demand for the Fund's new instruments, notwithstanding the high contagion risk associated with the crisis and the benefits reported for those that had used them, was still attributed to:

- The high qualification bar for the FCL or the lack of automaticity and predictability of access in the case of HAPA. These restrictions, necessary to safeguard Fund resources, considerably reduced the appeal of the facilities to members.
- Stigma. Despite the measures introduced to reduce stigma, the fear of sending signals of weakness continued to be present; past negative experiences with the IMF continued to cast their shadow; and conditionality continued to be perceived as heavy-handed and intrusive.
- Concerns in the case of the FCL about the consequences of exiting the arrangement either mid-way (by losing eligibility) or at the end of it.

- The existence of alternatives. For those that could avail themselves of alternatives, there was the possibility of using central banks' swap lines,[30] low-conditionality financing from multilateral development banks, and self-insurance through reserve accumulation (IMF, 2010a, p. 15).

52. Much of the internal debate at the Fund circled around this latter point. The debate was likely also influenced by considerations over the effects that a country's reserves policy has on its exchange rate and competitiveness. The discussion acknowledged the benefits that reserve accumulation brought to a country in terms of independence and automaticity, the positive signal it gives to markets, and the help it provides in dampening the cost of adjustment in the event of a crisis. However, these benefits were seen not to outweigh the costs associated with foregone consumption and investment. IMF staff argued that "[r]educing incentives for excessive self-insurance points to reserve-like (i.e., predictable and automatic) financing instruments, backed by adequate resources. But, going in this direction requires mechanisms to contain moral hazard and risks to the Fund, such as stronger links of lending terms or policy conditionality to the strength of the borrowers' fundamentals and policies" (IMF, 2010a, p. 7). Against this light, in August 2010, the Executive Board approved modifications to the FCL and the creation of a new instrument, the **Precautionary Credit Line** (PCL).

53. The changes introduced to the FCL sought to increase its attractiveness by doubling the duration of purchase rights under it so that arrangements could be approved for a period of either one year with no interim review, or two years with a review of qualification at mid-point. The expectation that access under FCL arrangements was normally not to exceed 1000 percent of quota was removed,[31] and finally, in order to reduce adverse signal effects of an exit from the facility, the expectation was introduced that a successor FCL arrangement would normally be granted at a lower access than for the previous one (IMF, 2010c).

54. The PCL was to strengthen crisis prevention in countries with sound policies but facing remaining vulnerabilities that would disqualify them from the FCL. The facility would provide frontloaded access—up to 500 percent of quota upon approval—subject to qualification requirements and limited ex post conditionality, focused on the remaining vulnerabilities. PCL arrangements could be approved for a period of one to two years with semiannual reviews and would be subject to the same charges and repayment periods as FCL arrangements and SBAs.

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[30] At that time, despite reaching historic highs, the resources committed by the IMF with SBAs and FCLs combined (US$170 billion) were comparable to the swap lines offered by the U.S. Federal Reserve to just four emerging market economies (US$120 billion) (IMF, 2010a, p. 14).

[31] The 1000 percent cap gave a weak signal to the markets and could have attracted undue attention in the event that potential financing needs were to have been larger.

55. The PCL shared many features with the FCL—the same financial terms and emphasis on ex ante (though less stringent) conditionality. But it also included ex post conditionality and was to be available only to members that did not have an actual balance of payments need, features common with the HAPA. Indeed, the PCL had the potential to replace the HAPA, which was viewed by some countries as "unattractive because—as a form of SBA—it may be associated with crisis resolution, with a presumed need for strong policy adjustment monitored with heavy conditionality" (IMF, 2010b, p. 6). From the point of view of potential users, the PCL—with similar qualification and access conditions as the HAPA but with focused and review-based conditionality—would be the superior instrument. Coming full circle, the PCL, a hybrid of ex ante and ex post conditionality closely resembled the Rapid Access Line (RAL) that had been considered in the period leading up to the 2008 crisis.

56. The PCL found one user—FYR Macedonia, in early 2011—that draw under it three months into the program. Nevertheless, unease with the adequacy of the IMF's lending toolkit persisted, in particular in regard to large and frontloaded crisis prevention financing. Concerns arising from the turmoil in the euro area, and the difficulties with avoiding contagion faced by "crisis bystanders"—countries with otherwise strong policy track records and fundamentals—led to a proposal to make the PCL more flexible by (i) allowing its use when there is already a balance of payments need at the time of approval, and (ii) allowing six-month duration arrangements. These modifications, adopted in late 2011, merited a change of name for the facility, which now became known as **Precautionary and Liquidity Line** (PLL). As of mid–2014, only Morocco has availed itself of the PLL.

57. In establishing the PCL, later changed into the PLL, the Board expected that its qualification requirements would be less stringent than those of the FCL, although most of the FCL criteria would still need to be met. There was substantial room for judgment in interpreting what constitutes the "very strong" fundamentals required for the FCL and what "sound [fundamentals] with some vulnerability" means in practice for qualification to the PLL. Moreover, while qualification for the FCL was based on the observance of nine specific criteria—which reflect assessments of the external position, access to markets, soundness of fiscal and monetary policies, strength of financial sectors, and data adequacy—the PLL was based on five general criteria that only refer to these areas. In February 2014, Executive Directors "…recognized the inherent challenge in identifying the minimum standard needed to meet the PLL qualification requirements in practice" and "saw merit in aligning the areas for qualification" (IMF, 2014b). The PLL qualification criteria were subsequently moved towards those of the FCL (IMF, 2014d).

58. Differentiating between the criteria for accessing the PLL and the SBA is also an issue. The lack of an actual balance of payments need at the time of approval had been set as a qualification criterion for the PCL in part to compensate for its lower ex ante qualification bar. Dropping this requirement made the PLL both a crisis prevention and resolution instrument, but blurred the line separating it from the SBA. The decision whether a country

should opt for a PLL or SBA was left to the Fund's judgment about the strength of the country's fundamentals and policy record at the time of the request. Moreover, even though the PLL carries ex post conditionality,[32] in practice the PLL has been associated with a "remarkably limited" ex post conditionality relative to HAPAs (IMF, 2014a, p. 19) and this conditionality has relied almost exclusively on indicative targets assessed at six-monthly intervals, which is far less burdensome than the conditionality of the typical SBA. As staff has indicated, "The introduction of multiple instruments … has created a system of tiering" (IMF, 2014a, p. 12). Indeed, while a variety of instruments may allow to tailor conditionality to the varying strength of members fundamentals and policies, the existence of three tiers (FCL, PLL, and SBA) may also have resulted in stigmatizing the use of the SBA.

59. It is not clear why there has not been much use of the PLL. Is the low use of the PLL due to lack of interest by members or to a dearth of countries able to meet the qualification criteria? If, on the one hand, demand for PLLs is high but staff and management's use of the qualification criteria is too strict, the undesired final effect may be not only to limit the use of PLLs, but also actually to reduce the *demand* for SBAs due to the fear of signaling stigma, especially for precautionary arrangements. On the other hand, as indicated in the Executive Board's 2014 review of these facilities: "Directors noted that the relatively modest use of the FCL and the PLL reflected a continued preference for self-insurance, including through reserve accumulation, by many members and remaining perceptions of stigma associated with Fund financing in general" (IMF, 2014c).

60. GRA instruments dealing with emergency assistance were also modified. In line with what had been done with the PRGT emergency facilities in 2009, the GRA instruments on ENDA and EPCA were replaced by a single instrument, the **Rapid Financing Instrument** (RFI) modeled closely on the RCF. At issue was that application of ENDA and EPCA had been compartmentalized and limited to a narrow set of emergency circumstances—i.e., financing needs arising from natural disasters and post-conflict situations, respectively. Non-PRGT eligible members with emergency financing needs had been left to rely on the SBA, despite the adverse circumstances they were in, which challenged their capacity to implement the SBA program. The role of the RFI remains untested. Thus far there has been no request since its creation in 2011. This notwithstanding, at the February 2014 review most Executive Directors supported keeping the facility unchanged.

61. As regards PRGT lending, reviews of LIC facilities in 2012 (IMF, 2012 and Sup. 1; IMF, 2012b) and 2013 (IMF, 2013) introduced some refinements. The blending policy was tightened anew to promote the progressive graduation from Fund concessional financing and preserve the self-sustainability of the concessional financing framework. Access limits, while still considered broadly appropriate after their doubling in 2009, were to be brought back to

[32] Countries requesting a PLL arrangement would commit to implement a focused set of policies aimed at addressing the remaining vulnerabilities.

their previous levels in terms of quota once the 14th General Review of Quotas became effective (which would result in most countries being left with unchanged, or even increased, access levels in SDR terms).[33] The cumulative access under the RCF was increased. To bolster the preventive usefulness of the ECF and SCF, their initial duration was extended and it was agreed to allow an augmentation of access between scheduled reviews in cases where the program is on track and there is a sudden need that cannot await the next scheduled review, and to consider augmentation requests not exceeding 25 percent of quota on a lapse-of-time basis. Also in this vein, it was agreed to permit greater frontloading of the SCF and easing time limitations on repeated use of SCFs treated as precautionary.

62. Interviews with senior IMF staff suggest that stigma does not seem to be as big a problem in core LIC borrowers as in emerging or advanced economies, which helps explain the sustained use of the new PRGT facilities among LICs. The PSI has been in demand as a signaling device to donors, while the ECF remains the "workhorse" in lending to LICs. IMF staff have also indicated that the ECF's three-year horizon seems to fit well with the World Bank and other donors' planning horizon for poverty reduction lending.

B. Exit Issues and the Revolving Nature of IMF Resources

63. The creation of precautionary instruments with their reliance on ex ante qualification gave rise to a new set of issues: how to deal with a country that mid-way through an arrangement ceases to qualify? The signaling benefits of having bought insurance could be more than wiped out once the insurer announced that it was terminating coverage. While countries could seek to draw before such a termination, if the need for such a purchase was not clearly related to an exogenous and unexpected development, it would call into question the rigor of the qualification requirements. Moreover, even if qualification were maintained throughout the duration of the arrangement, how to exit at the end without heightening market vulnerabilities?

64. The changes made in 2010 to the new precautionary instruments included an expectation that access would decline in successor arrangements, signaling lowered vulnerabilities and a gradual move toward exit. More generally, it was deemed necessary to adopt an adequate communication strategy by both the country and the IMF explaining the timing and circumstances of the exit process, but this notion was never objectively well defined. Nevertheless, the protracted nature of the crisis made exiting from the FCL difficult. All three FCL borrowers renewed their arrangements in 2010, with only Colombia doing so at lower access than before. After the duration of the FCL was extended in 2011, the three countries renewed their arrangements, this time for two years, and did so again in 2012–13 thereby extending their use of the FCL to six years.

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[33] Pending ratification, to date this quota increase has yet to take effect.

65. The risk of an exit because of failure to complete a mid-term review could not be entirely avoided; it could only be mitigated by the very strict initial qualification requirements, including the requirement for countries to be "very strong performers." The possibility of a forced mid-way exit also may have created a situation of "reverse stigma" as, if weaknesses emerge, IMF staff would be reluctant to change a country's "strong performer" status for fear of the market risks this would carry.[34]

66. As to exiting at the end of an arrangement, there is the tension between a facility intended to be of strictly temporary use and a reality in which risks are never absent. Risks are continuous and they vary only in intensity, thus it is only natural for countries to desire to buy insurance on a permanent basis. In other words, there is never a time in which a clear-cut decision to exit from a precautionary facility can be taken, thereby belying the assumption underlying precautionary facilities that an improved global situation would make the appropriateness of an exit evident. Concerns about the lack of exit have been increasingly voiced during successive requests for extension of the three FCL arrangements and at the Executive Board reviews of the new facilities: "Many Directors, concerned about undue repeated use of the FCL, saw merit in further work on stronger incentives to encourage timely exit…" (IMF, 2014b).

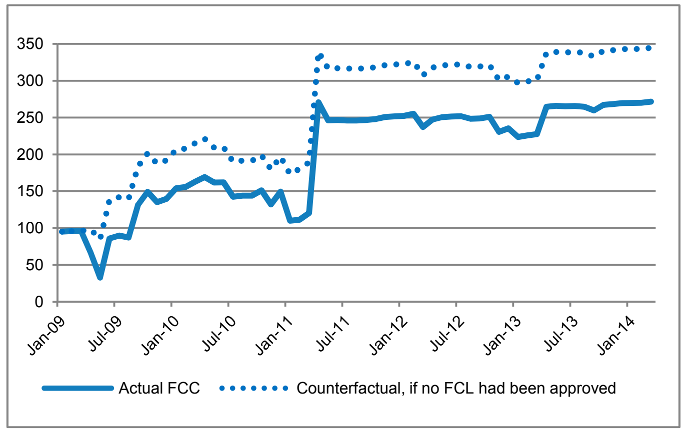
67. Interviews with officials from countries that have used the FCL indicate that, from their perspective, "exit must be contingent on the state of the global economy and the risks that it poses" to their country.[35] They agreed that, because the FCL does not have ex post conditionality, it will remain to be needed until the IMF clearly and unequivocally communicates that (i) global risks have subsided and (ii) countries using precautionary instruments can safely exit their arrangements. The observed reluctance to exit FCL programs may thus reflect a design problem (i.e., no explicit exit strategy). Also, the users' fear of a premature exit may be a factor in explaining the low number of FCL users: fear of exiting would preclude entry.

[34] Staff admits that "removing countries that no longer qualify from the list is likely to prove difficult in practice given the potential market reaction" (IMF, 2014a, p. 14). Survey evidence indicates that this is a concern of country officials (IMF, 2014a, Sup. 1, p. 4).

[35] Commenting on the recent discussion at the IMF about "incentives" to exit—involving time-based fees, or phasing of access for repeated use—one country official interviewed for this paper mentioned that the financial cost of the FCL to his country is not negligible and, therefore, financial incentives to exit do exist already, but noted that "it is just not the time" to do so.

68. While this has not been the case so far, given the issues about exit, the proliferation of very large and persistent precautionary arrangements runs the risk of crowding out resources for crisis resolution. Figure 3 shows that right after the reforms of March 2009, the first FCL arrangements nearly halved the IMF's Forward Commitment Capacity (FCC).[36] However, new borrowing arrangements in 2009–10 increased the total resources available to the IMF[37] and eased the pressure that the existing FCL arrangements puts on the IMF's ability to make other commitments, with about SDR 265 billion available for new lending as of end–2013.

Figure 3. FCC and FCL Programs
(In billions of SDRs)



Source: IMF's Financial Resources and Liquidity Position and SPR database (see http://www.imf.org/external/np/tre/liquid/2014/0114.htm).

69. In this context, time limits or time-based surcharges for prolonged use of precautionary facilities—conditional on the external risks facing the country—were discussed within the IMF, as well as the use of an indicator of external risks to add more objectivity to the discussion on both access and exit from PLL and FCL. No decision on time limits or time-based surcharges was made, while the Board requested the preparation of an indicator of external stress to help inform the discussions about exit but not about access (IMF, 2014d).[38]

[36] The FCC represents the resources available for the IMF to lend in the next 12 months.

[37] In 2009–10, borrowing arrangements were established with individual member countries and formalized through an enhancement of the existing New Arrangements to Borrow (NAB).

[38] For the time-based surcharges, see IMF (2014a), pp. 30–35. For the indicator of external stress, see IMF (2014a), pp. 21–22 and IMF (2014c).

V. Assessment and Conclusions

70. Overall, the reforms undertaken in response to the 2008 crisis, including the new instruments, have addressed many of the concerns the membership had and have contributed to increasing the attractiveness of IMF lending. Progress was made in expanding the resources available for lending, increasing access limits, allowing greater frontloading,[39] and promoting more supportive economic policies. The latter allowed for stronger countercyclical responses and smoother adjustments to the effects of the financial crisis.[40] These steps also contributed to increasing the attractiveness of the existing lending facilities, such as the SBA, and to adapting the lending toolkit to changing country needs, including in dealing with more frequent capital account crises.[41] The reforms to the GRA and conditionality frameworks, while generally welcome, went however only part of the way to ameliorate stigma and reduce the reluctance to seek Fund assistance. The perception of political stigma appears to have been reduced lately, but survey evidence indicates that stigma (both signaling and political) is still a major issue for IMF lending.[42]

71. With the creation of the precautionary instruments plus the RFI, a streamlined toolkit now covers the whole spectrum from adjustment, through precautionary, to emergency lending. Along similar lines, the reform of the PRGT facilities went a long way to eliminate overlaps, cover existing gaps, and increase the attractiveness of IMF lending to LICs. The substantial increase in both the concessional lending capacity and access limits granted a welcome additional "fire power" to the IMF's ability to respond to problems in LICs. These

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[39] In a sample of 125 IMF programs granted between January 2000 and April 2014, for which data on first disbursements under the program are available (representing about half of all programs during that period), the average ratio of the first disbursement to the total amount committed increased from 9.7 percent before 2008 to 16 percent in 2008 and after. This trend to frontloading resources seems to be diminishing as we move away from the financial crisis. After a peak of 43 percent in 2008, first disbursements as a share of total commitment are steadily going down, to 13.7 percent by April 2014.

[40] A review conducted by Fund staff of 15 SBAs with emerging economies approved between September 2008 and July 2009 concluded inter alia that: "The adjustment in external balances has mostly been less wrenching than in past crises, reflecting a mix of timely, higher and more frontloaded financing and supportive macroeconomic policies (IMF, 2009f, p. 3).

[41] The total IMF credit committed increased from less than SDR 10 billion, in 2007, to SDR 38 billion in the following year, reaching a peak of about SDR 216 billion in March 2012.

[42] See IMF (2014a). Time has passed since the "bad experiences" with the Fund during the 1980s and 1990s, making part of the negative image of IMF intervention fade away. In addition, the central role the IMF played in the recent financial crisis raised its prestige (perhaps, in part due to the new instruments created). The fact that even advanced economies came to the Fund for assistance may also have helped in regards to stigma. On the other hand, interviews with country officials show that in certain parts of the world political stigma remains strong and that it is very unlikely that any marginal change to the design of precautionary instruments will attract borrowers unless they have exhausted other possible alternatives.

reforms may take part of the credit for the reported lessening of stigma and have been broadly seen as successful by member countries.[43]

72. A recent IMF staff review paper on the new precautionary instruments (IMF, 2014a, p. 11) and our own interviews with country officials from FCL and PLL users and with IMF mission chiefs who worked with these countries—both at the time of the inception of such programs and since then—indicate that users have been quite satisfied with these facilities. Authorities from FCL countries said that the FCL "is a very useful mechanism," "acted as a signaling device, with the IMF's 'seal of approval' of the country's policy-making," and that "it has the right incentives for countries to follow the right policies, representing an important effort to boost the effectiveness of the IMF lending toolkit." They also stated that this instrument was indeed able to overcome existing stigma concerns and facilitated the domestic political discussion on the program's implementation. Interviewees indicated that without the new instruments there would not have been any program because of the political stigma associated with SBAs.

73. Staff has also provided evidence suggesting that these instruments helped reduce spreads for both FCL and PCL/PLL countries. Indeed, spreads declined for these countries, but so did spreads all across the market. It can be argued that a halo effect extended to countries with similar strengths as Colombia, Mexico and Poland, and that this, together with the extra financial firepower given to the IMF, was the primary cause for the lowering of the crisis' pressure after 2009; but, as staff acknowledged in 2010, "the presence of only three FCL countries … render impossible a robust quantitative assessment of the impact of entering into FCL arrangements on country spreads."[44] Staff further cited country authorities' statements indicating that "access to the FCL had helped them to maintain market [sic] access—with significant bond placements at favorable yields—creating room for countercyclical policies" (IMF, 2010a, p. 13). Similar positive but statistically not significant effects on spreads are reported in the January 2014 review of the instruments.

74. These positive views about the new instruments need to be tempered by the realization that they refer to very few cases. Since the three FCL and the two PCL/PLL arrangements were approved, no other country has expressed interest or been able to qualify for either instrument. This was particularly noticeable at the time in mid-2013 following the episode of market stress and volatility that ensued after the announcement of the "tapering" of monetary stimulus in the United States.

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[43] See IMF (2013), p. 6, and also the views of officials from Sub-Saharan Africa in the Maputo Joint Declaration, "Africa Rising: A Shared Vision For Sustained Growth And Prosperity," Press Release No. 14/251, May 30, 2014, available at http://www.imf.org/external/np/sec/pr/2014/pr14251.htm.

[44] In addition, issues related to difficulties in constructing the appropriate counterfactual cases to use in comparisons, reverse causality, and endogeneity may also affect the staff's conclusions.

75. Although it is likely that both demand and supply factors contributed to the low number of these arrangements, when asked about factors inhibiting FCL and PLL use, country officials indicated “preference for self-insurance through reserve accumulation,” “access to alternative financing instruments,” and “stigma associated with the use of IMF resources,” ahead of “rigorous qualification criteria.”[45] Also, as explained above, many Board members and some country authorities had openly expressed concerns about the impact that additional large FCLs would have on the ability of the IMF to finance countries with actual (as opposed to potential) needs.

76. From our interviews, it also became clear that exit issues are the main source of concern regarding the FCL.[46] Both authorities and mission chiefs involved with countries currently using the FCL agree that the issue of how long countries were expected to use the FCL was not properly discussed when the facility was created. To quote one country official: “at the time (2008–09), everybody was optimistic about a quick recovery and the original idea was that the FCL was to be used for a short period of time. There was no discussion about what would happen if the crisis lasted longer and the consequences of this lack of foresight are seen today.” Along the same reasoning, another official added that “the moment for the IMF to establish directives and outline which conditions are expected to trigger exit has passed,” suggesting that a mistake during the exit process could undo all the benefits thus far, and lead to the elimination of the instrument.

77. Reviews of precautionary facilities conducted by IMF staff and associated Board discussions indicated a need to clarify the eligibility criteria for the FCL relative to the PLL, and probably more so between the PLL and the SBA/EFF,[47] although mission chiefs interviewed downplayed these concerns. In particular, Board discussions indicate a fear that the PLL may have introduced a redundancy in the lending toolkit, without creating sufficient additional benefits in terms of crisis prevention. It is still too early to assess whether the new set of qualification criteria approved by the Board in May 2014 will succeed in clearly differentiating the PLL from precautionary SBAs.

78. Table 1 broadly summarizes the extent to which the goals and guiding principles of the 2009 reforms of the IMF lending toolkit have been achieved.

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[45] Both FCL users and potentially “eligible” countries continued to accumulate reserves after the March 2009 reforms were approved. For example, between March 2009 and December 2013, reserves in Mexico increased by 105 percent. Similar rates of reserve accumulation took place in Colombia (84 percent), Poland (75 percent), Brazil (88 percent), Indonesia (83 percent), and South Korea (66 percent). Between 2008 and 2012, the reserve pooling under the Chiang Mai Initiative increased threefold, from US$78 billion to US$240 billion.

[46] This is also confirmed by staff’s recent survey. See IMF (2014a, Sup. 1, pp. 3-4).

[47] Survey evidence indicates that country officials agree that “[i]ncreasing the stigma with blurring distinction between PLL and SBA” is among the issues facing the PLL (IMF, 2014a, Sup.1, p. 5).

Table 1. Have the Objectives of the 2009 Reforms Been Achieved?

(a) Increase the attractiveness of IMF lending	**Not fully accomplished.** Crisis resolution facilities became more attractive in aspects of conditionality, financial terms, and access limits. On the other hand, use of the new precautionary instruments has remained limited.
(b) Streamline the lending toolkit	**Accomplished.** The lending toolkit, for both GRA and PRGT facilities, has been simplified and rationalized.
(c) Address gaps in the toolkit	**Partially accomplished.** New precautionary instruments—broadly accepted by members—were created. However, these instruments are a work in progress as several unresolved issues remain.
(i) A pure signaling instrument	**Not accomplished.** The creation of a pure signaling instrument did not attract sufficient interest.
(ii) A crisis-prevention instrument	**Too soon to ascertain.** Staff has provided some evidence that the newly created FCL and PLL may have helped both actual and potential users. On the other hand, reserve accumulation and alternative sources of insurance continue to thrive; and no new FCL or PLL has been approved even when heightened market volatility has affected potentially "eligible" users. Exit from the FCL and qualification for the PLL are major issues.
(iii) A short-term liquidity instrument	**Partially accomplished.** The FCL and the PLL contribute to this objective.
(d) Update and increase the relevance of the PRGT facilities	**Accomplished.** The lending facilities targeting LICs have been "cleaned up" and streamlined, a short-term liquidity facility and a concessional stand-by facility have been created, and both the concessional lending capacity (more than doubled) and access limits (doubled) substantially increased in 2009.

79. Table 2 summarizes our assessment of the status of the issues raised during the discussions on new facilities, described in Section III.A above, and shows that, five years after the 2009 reforms of the IMF lending toolkit, these issues continue to be open for debate.

Table 2. Assessment of Other Aspects of the 2009 Reforms of the IMF Lending Toolkit

(a) Safeguarding the revolving nature of the Fund's resources and preserving the IMF's lending capacity	The new precautionary instruments have reduced the FCC. However, this has been more than offset by new borrowing arrangements.
(b) Uncertainty about qualification for precautionary arrangements	**Remains an issue**. There is still substantial room for subjective judgment as regards the qualification for the FCL and PLL. The distinction between qualification for the PLL and precautionary SBAs has been blurred.
(c) Reduce stigma	Although reduced, stigma is **still a major issue** for IMF lending. The creation of the PLL may have increased signaling stigma for the SBA.
(d) Moral hazard	**Not clear** whether the 2009 reforms affected moral hazard.
(e) Conditionality	**Has been streamlined, and relaxed** at the margin. The new facilities make greater use of ex ante and less use of ex post conditionality. Structural performance criteria were eliminated.
(f) Financial terms	Have become **more favorable**. Costs have been lowered for LICs, while repayment horizons have been extended. Resources are being frontloaded more often.
(g) Access limits	**Increased**, compensating partially for the fact that quotas have not been yet adjusted.
(h) Exit from FCL/PLL	**Remains an issue**. None of the FCL users have successfully exited from their programs.

80. A salient feature of the reform process was the partial return of judgment-based ex ante conditionality, with greater prominence given to discretion in contrast to established rules in regard to the use of Fund resources. Preventive instruments require placing greater emphasis on judgment. They need to give certainty of access to resources whenever required by an adverse turn of events, and this implies pre-qualification on the basis of a discretional assessment of a country's situation, including the strength of its fundamentals and policy implementation record. Efforts were made to establish certain assessment principles, but in the end the matter rests on a judgment call by the Fund. "Ultimately…there are no 'bright line' numerical qualification criteria…and the qualification frameworks contain nuanced and judgmental elements, including in the quantitative assessment. Since subjectivity is inescapable, the discussion in the qualification assessments needs to provide a suitable basis for ensuring transparency…" (IMF, 2011, p. 29).

81. Establishing a widely accepted preventive instrument was a major challenge that in the end could not be fully met. The new precautionary instruments are an improvement over past experiences, but there are still important unresolved issues related to qualification, lingering stigma concerns, the IMF's resource envelope, and exit from precautionary arrangements. These issues continue to limit the ability of the IMF to provide insurance againt crises to more than a few of its members. The task of finding a widely used preventive facility is still outstanding.

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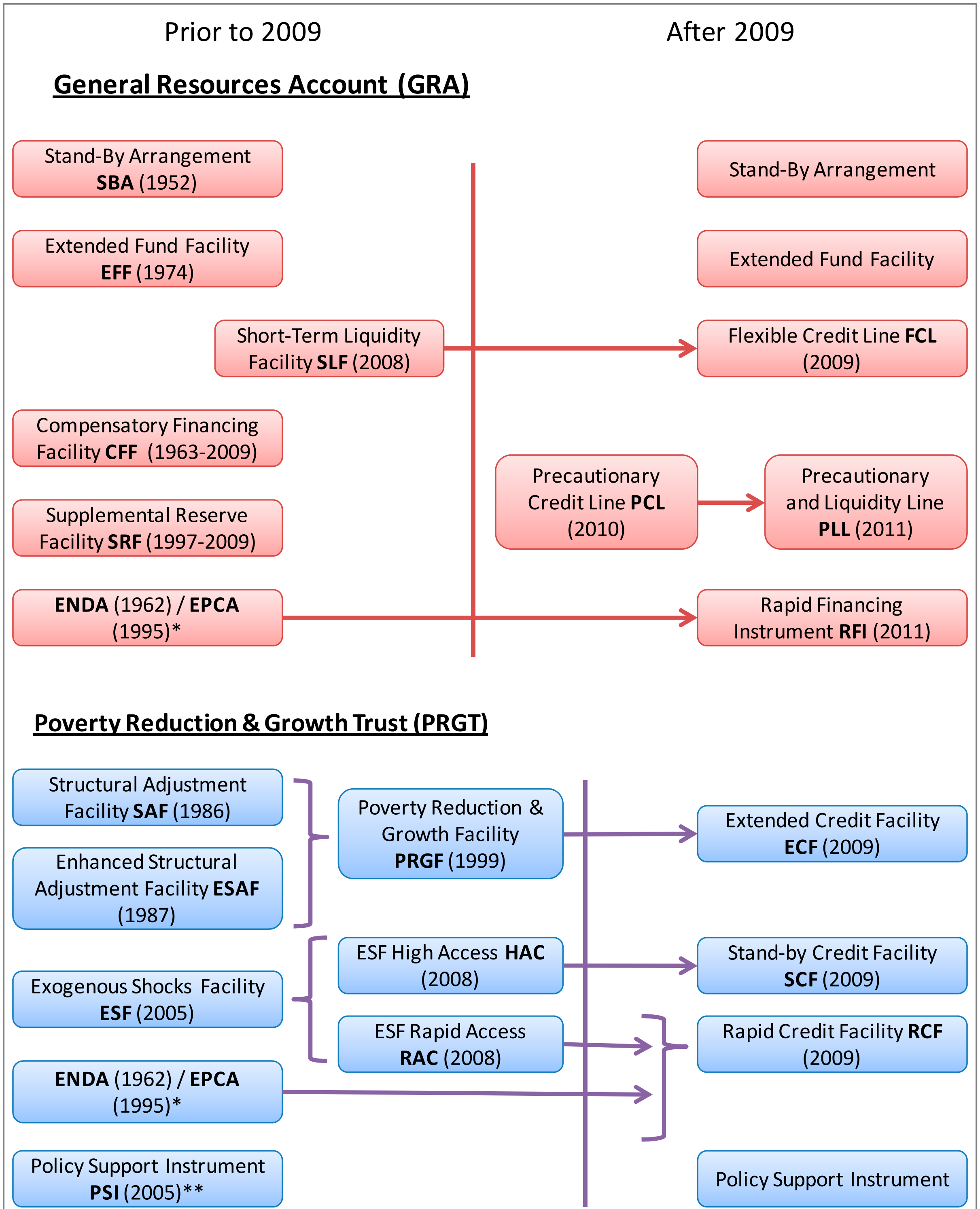
ANNEX 1. IMF LENDING INSTRUMENTS



* Outright purchases for Emergency Natural Disaster (ENDA) or Post-Conflict Situations (EPCA)
** Non-financial instrument