IMF Publication

Review of the Compensatory Financing Facility

INTERNATIONAL MONETARY FUND

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In Consultation with other Departments

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February 18, 2004

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I. INTRODUCTION

1. **The Compensatory Financing Facility (CFF) was created in 1963 to help members cope with temporary export shortfalls caused by exogenous shocks.** The facility has been modified on a number of occasions. The coverage of export shortfalls has been broadened, an element for excess costs of cereal imports introduced, a contingency financing element added and dropped, an oil element with a sunset clause added and allowed to expire, and access limits adjusted. Since the most recent changes in 2000, the CFF has not been used.

2. **Several important changes in the CFF were introduced in 2000 in the context of a broader review of the Fund's facilities.** The structure of access limits was simplified, and it was recognized that most drawings under the CFF would need to be accompanied by economic adjustment to address preexisting balance of payments weaknesses. Thus, the Executive Board established that the CFF would be available either in the context of a Fund arrangement or in cases where a member's balance of payments position is deemed satisfactory apart from the temporary export shortfall or cereal import excess.[1] The review also called for a reexamination of the modified facility after two years.[2]

3. **The current review of the CFF takes place in parallel with a broader review of the role of the Fund in low-income countries.** The types of shocks for which the CFF is designed tend to afflict disproportionately low-income countries, and any review or reform of the CFF needs to take into account the changes in the Fund's overall approach towards low-income members. The Executive Board considered approaches to dealing with exogenous shocks in low-income countries in September 2003, and this issue is developed further in the companion to the present paper entitled "The Fund's Support of Low-Income Member Countries: Considerations on Instruments and Financing".[3]

4. **The paper is organized as follows:** Chapter II provides a brief background on the purposes of the CFF. Chapter III goes over the key modifications introduced to the facility in the 2000 review and the experience with the facility since the review. Chapter IV covers the policy issues for review; it begins with an examination of the underlying premises of the CFF and then considers some possible changes to the facility. The paper concludes with issues for discussion in Chapter V.

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[1] The CFF decision as revised in 2000 defined "arrangement" for its purposes as an upper credit tranche stand-by arrangement, an extended arrangement, or an arrangement under the PRGF.

[2] The review was delayed to take place in the context of the review of the role of the Fund in low-income countries.

[3] See "Fund Assistance for Countries Facing Exogenous Shocks" (SM/03/288, 8/11/03), and "Concluding Remarks by the Chair—Role of that Fund in Low-Income Member Countries Over the Medium Term, and Fund Assistance for Countries Facing Exogenous Shocks" (BUFF/03/164, 9/5/03).

II. PURPOSES OF THE CFF

5. **The CFF was established to help member countries avoid undue adjustment in the face of a temporary decline in export earnings due to exogenous events.**[4] Originally, only shortfalls in merchandise exports were eligible for compensation, but the facility was expanded in 1979 to cover shortfalls in receipts from tourism services and workers' remittances. In 1981, coverage was expanded further to include excess cereal import costs.[5]

6. **The fundamental characteristics of the CFF derive from the assumption that shocks are temporary and thus self-correcting.** In principle, a reversible shock makes adjustment—and thus corrective adjustment policies—unnecessary, beyond what is needed to ensure timely debt service. The CFF provides:

- *Low conditionality financing, under certain circumstances.* Requests for stand-alone CFF purchases, i.e. not in parallel with a Fund arrangement, will be met when the member's balance of payments is satisfactory apart from effects of the shock being compensated.

- *Formula-based access.* The CFF provides for full compensation, up to a limit, of a balance of payments need arising from the export shortfall or cereal import excess. The specific limits have varied over the years, and until 2000 were dependent on the degree of cooperation with the Fund.

- *Floating access.* Purchases under the CFF do not count towards the access limits for other facilities. Thus, for instance, financing of economic adjustment policies pursued under upper credit tranche stand-by arrangements, the Extended Fund Facility (EFF), or the Poverty Reduction and Growth Facility (PRGF) is not reduced by outstanding purchases made under the CFF.

- *Upfront disbursement.* Even where adjustment and conditionality is needed, the full amount of financing can be made available within six months once the size of the shock can be estimated with reasonable accuracy.

7. **The CFF is designed to deal with temporary shocks to export receipts and workers' remittances, whereas on the import side it is limited to cereals.** The decision to extend financing under the CFF to cover cereal import excesses was made largely in response to humanitarian concerns. More generally, the narrower coverage of imports reflects the principle that the CFF should be used to finance only exogenous shocks, while import excesses may often be related to domestic policies. There may also be practical difficulties in

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[4] Decision No. 1477 (63/8), February 27, 1963.

[5] An oil import element was temporarily introduced in 1990 to compensate for increases in fuel import costs in the run-up to the first Gulf War; it expired at the end of 1991.

measuring imports with sufficient accuracy. A more fundamental reason that export compensation is emphasized rests on the appropriate policy response to export versus import shocks. A temporary shock to export receipts constitutes an adverse aggregate demand shock, with a recessionary and deflationary impact. In this context, full compensatory financing that helps maintain aggregate demand at its pre-shock level would in principle be warranted (presuming the balance of payments did not have other problems). By contrast, a shock to imports would typically affect the supply side of the economy and would have a recessionary but also an inflationary impact. Full accommodation of a supply shock through compensatory financing and increases in aggregate demand may not always be the appropriate response, giving rise to a policy conflict. In general, this would call for some combination of financing and adjustment (or financing in the context of a broader adjustment program), in order to avoid second-round effects on wages and prices that could lead to sub-optimally high inflation.

8. **Modifications to the CFF over the years reflect the tension between the principle of compensatory financing and the difficulty in practice to identify the circumstances when such financing is appropriate.** The CFF was created as a low conditionality facility with rapid response. Over time, the access limits were expanded and, to contain the risks, increasingly stringent tests of cooperation with the Fund were added for drawings at higher levels of access.[6] As a result, the CFF became a complex facility that was difficult to use and administer.

III. MODIFICATIONS TO THE CFF IN 2000

9. **During the 2000 review, a majority of Directors preferred to retain a streamlined CFF, although some Directors favored eliminating the facility altogether.**[7] Several Directors cited the vulnerability of some members to temporary shocks, and the transitory component of commodity price slumps, as reasons for retaining a special facility. Those Directors that favored abolishing the CFF altogether noted that the question of temporariness is hard to judge in advance; that the facility poses risks of providing access to Fund resources with relatively low conditionality in circumstances where there is often a need for economic adjustment and higher conditionality; that the provision up-front of significant CFF resources can weaken economic reform incentives; and that needs for compensatory financing can reasonably be satisfied under a Fund arrangement.

[6] A brief history of the CFF is presented in Box 2 of EBS/99/222 (12/9/99).

[7] See “Summing Up by the Acting Chairman, Review of the Compensatory and Contingency Financing Facility (CCFF) and Buffer Stock Financing Facility (BSFF)—Preliminary Considerations” (BUFF/00/9; 1/20/2000); and “Summing Up by the Acting Chairman, Review of Fund Facilities—Preliminary Considerations,” (BUFF/00/41; 3/24/2000). In the context of the review, the Buffer Stock Financing Facility (BSFF) and the External Contingency Mechanism (ECM) were abolished.

10. **The review tightened the circumstances for unconditional access to CFF resources, and simplified the structure of access limits under the facility.**[8] Experience had shown that in all cases where CFF resources had been used since 1989, the member had wider balance of payments problems that would have warranted some adjustment. In such circumstances, the criterion of past or prospective "satisfactory cooperation" with the Fund had been used to determine whether a stand-alone CFF purchase could be approved; this, however, was seen as involving judgments that were difficult to make in a consistent manner across the membership (Figure 1). Concerns about these tests had also led to a complex system of access limits. The main features of the existing CFF are outlined in Box 1, and the characteristics of CFF assistance since 1990 are summarized in Table 1.

11. **The CFF has not been used since it was modified, despite at least two temporary and exogenous shocks that affected several members.**[9] First, a number of economies, mainly in the Caribbean and the Middle East saw a major loss of tourism revenues after the attacks of September 11, 2001. Using WEO data, 19 members were particularly affected, and had average export shortfalls in 2002 of more than 50 percent of quota. Second, a major supply shock in cereal production related to drought and security problems in southern Africa in 2002 raised import costs of cereals for several countries in the region, with cereal import excesses ranging from 20 to some 140 percent of quota.[10]

12. **Fund staff discussed the possibility of CFF access with a number of the affected members, but countries decided to use other options to deal with the shocks.** Most of the middle-income countries concerned either had comfortable access to alternative financing or a strong reserve position that enabled them to absorb the shock (e.g. Tunisia). At least one member expressed some initial interest in a CFF purchase, but was judged by staff to have underlying balance of payments problems and did not wish to pursue an arrangement with upper credit tranche conditionality. In general, these middle-income countries managed to weather the shock through a combination of non-Fund financing, use of reserves, and, in a few cases, increased exchange rate flexibility. As for the low-income members affected by the shocks, several resorted to alternative forms of Fund financing, including PRGF augmentations (Ethiopia, Zambia) and Emergency Assistance (Malawi). Others that might have qualified did not feel a need for augmentation under the PRGF (Lesotho, Mozambique, Tanzania). Some countries had other financing options at more attractive terms than under the nonconcessional CFF.

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[8] Decision No. 12325, November 13, 2000. The operational details of the modifications are set out in "Amendment of the Compensatory Financing Facility," (EBS/00/215; 11/2/2000).

[9] The last purchase to date was made in August 1999 by the F.Y.R. Macedonia.

[10] For a more comprehensive analysis of these shocks, see Annexes I and II.

Box 1. The CFF—Current Features and Recent Modifications

Qualification. Countries may use CFF resources if they experience temporary shortfalls in export earnings or excess cereal import costs or both. The shortfall or excess has to be largely due to factors outside the authorities' control, and must result in a balance of payments need. Shortfalls in one category of exports are netted against excesses in other categories, and cereal import excesses are netted against export excesses. Requests for stand-alone purchases are met only if the balance of payments position is satisfactory apart from the export shortfall or cereal import excess. In cases where the balance of payments is not deemed satisfactory, requests for CFF purchases can only be met in conjunction with an upper credit tranche-type arrangement. *This represents a tightening of the criteria for stand-alone access, i.e. not in conjunction with an upper credit tranche-type arrangement, and was introduced in 2000 to reduce the need for difficult judgments required in the previous system, and reflects the need for some adjustment where balance of payments problems extend beyond the export shortfall or cereal import excess.*[1]

Access limits. The determination of access is formula-based. There is a uniform limit of 45 percent of quota for compensation of export shortfalls or cereal import excesses, and of 55 percent of quota for a combined compensation. Access under the CFF thus is not subject to the limits applying in the credit tranches and under the Extended Fund Facility. *The simplification of the structure of access limits in 2000 replaced a complex system of limits depending* inter alia *on the degree of cooperation with the Fund and the member's willingness to adopt policies that would meet the standards of upper credit tranche conditionality.*

Terms. Repurchase obligations under the CFF fall due 3¼–5 years from the date of drawing, and repurchase expectations arise over 2¼–4 years. The basic rate of charge under the General Resources Account applies to CFF purchases. CFF purchases are not subject to the level-based surcharges applying to purchases under the credit tranches and the EFF.

Conditionality. Purchases in conjunction with an upper credit tranche-type arrangement are linked to the conditionality of that arrangement. Stand-alone purchases under the CFF are not subject to conditionality. CFF purchases, like all purchases under GRA facilities, are taken into account in determining the availability of first credit tranche conditionality.

Tranching. CFF access in conjunction with an upper credit tranche-type arrangement is made available in at least two tranches to ensure that access is aligned with the member's need and the implementation of corrective policies. Stand-alone CFF access can be made available in a single purchase. However, if nine months or more of the underlying data used for the calculation of the shortfall or excess are estimates, only 65 percent of the total amount of compensatory financing can be made available as a first purchase, and the remainder is provided (if the shortfall is confirmed) when at least six months of actual data are available. *The phasing of purchases in conjunction with an upper-credit tranche-type arrangement was introduced in 2000.*

Calculations. The shortfall is calculated as the deviation from the five-year geometric average for export shortfalls, and a five-year arithmetic average for cereal import excesses, centered on the compensable year. Data for up to the full shortfall or excess year may be estimated. The member is expected to make a prompt repurchase if the amount purchased based on estimated data exceeds that available on the basis of actual data.

1/ Subsequently, the concept of a satisfactory balance of payment position has been developed in more detail (see Annex III).

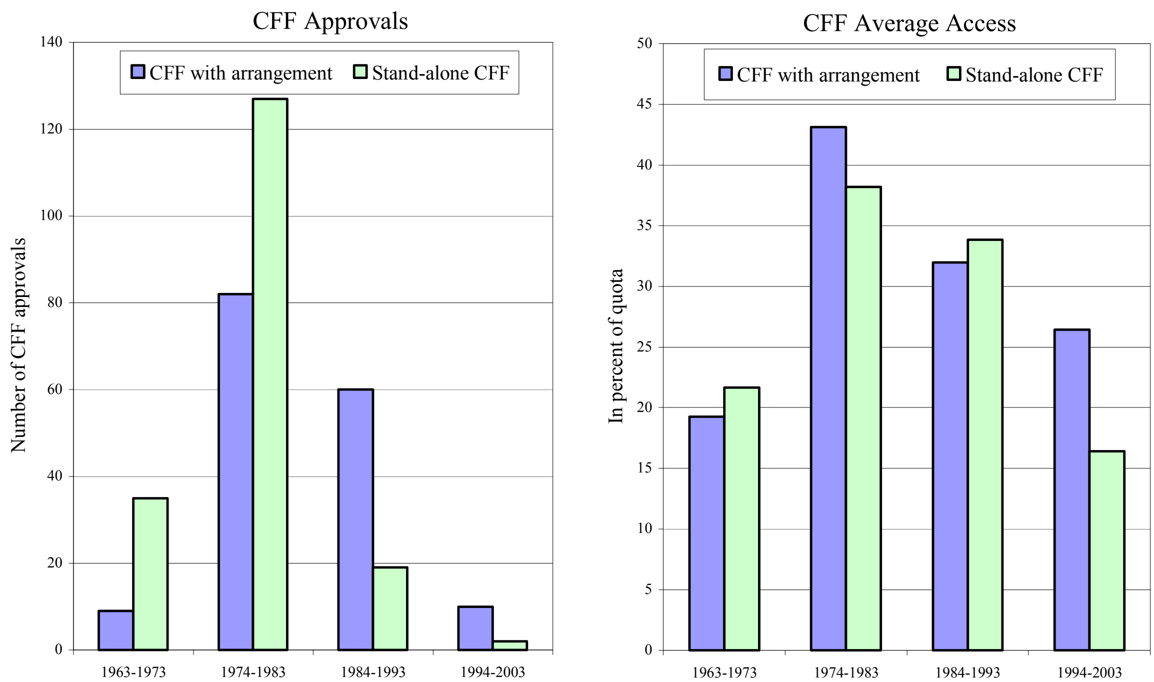
Table 1. The Nature of Compensatory Financing Facility Assistance, 1990-2003

Country name	Date of Drawing	Fund Program	Access (in percent of quota)				Explanation for Shortfall in Staff Report				
			Export	Cereal	Oil 1/	Contingency 2/	Price	Weather	External Demand	Remittances	Production
Export Shortfall											
PRGF-eligible											
Cote d'Ivoire	9/13/90	X	15				X				
Honduras	2/20/92		46					X			X
Ghana	7/19/93		17				X				
Rwanda	11/1/95		15								X
Pakistan	1/15/99	X	34				X	X	X		
Azerbaijan	1/28/99	X	35				X				
Not PRGF-eligible											
Papua New Guinea 3/	5/1/90	X	65								X
Philippines	2/25/91	X	24		39			X	X		
Costa Rica	4/11/91	X	7		33		X		X		
Jamaica	7/3/91	X	7		4		X				
India	7/22/91		6		2		X		X	X	
Dominican Republic	9/3/91	X	6		34		X	X			
India	9/16/91		21				X		X	X	
Barbados	2/12/92	X	65						X		
Panama	2/27/92	X	2		34		X		X		
Israel	4/1/92		40						X		
Dominican Republic	7/14/93	X	22				X		X		
South Africa	12/28/93		30	15			X	X			
Gabon	4/5/94	X	19				X				
Algeria	6/2/94	X	24	6			X				
Russian Federation	7/22/98	X	50				X				
Jordan	4/20/99	X	20						X	X	
Algeria	6/1/99		18				X				
Macedonia, FYR	8/9/99	X	20						X		
Cereal Element Only											
Not PRGF-eligible											
Moldova 4/	2/8/93			15				X			
Moldova 4/	12/22/94	X		14				X			
Algeria	6/30/96	X		19			X				
Bulgaria	4/16/97	X		23				X			
Oil Element Only 1/											
PRGF-eligible											
India	1/23/91				32		X				
Pakistan	12/19/91	X			22		X				
Not PRGF-eligible											
Bulgaria	2/28/91	X			20		X				
Czechoslovakia	1/10/91	X			53		X				
Czechoslovakia	6/24/91	X			14		X				
Hungary	1/22/91	X			43		X				
Jamaica	2/27/91	X			14		X				
Poland	4/23/91	X			24		X				
Romania	3/20/91				40		X				
Romania	4/16/91	X			7		X				
Czechoslovakia	1/15/92	X			17		X				
Hungary	3/26/92	X			5		X				
Romania	6/15/92	X			10		X				
Contingency Element Only 2/											
Not PRGF-eligible											
Bulgaria	3/11/92	X				12	X				
Summary Statistics (Total=42)											
Number		31	23	6	18	1	31	8	11	3	3
Percent of total 5/		74	55	14	43	2	74	19	26	7	7
Average		...	25	15	24	12	...	...	...	...	...

Source: Staff reports.

1/ The temporary oil element expired in December 1991, though purchases were allowed through June 1992 for shortfalls occuring before the expiration date.
2/ The contingency element of the CCFF was eliminated in November 2000.
3/ Became PRGF-eligible on June 11, 2003.
4/ Became PRGF-eligible on March 23, 1999.
5/ Percentages may not add up to 100 as some drawings were made under multiple elements or for multiple reasons.

Figure 1. Compensatory Financing Facility, Incidence and Access



Source: Executive Board staff reports.

IV. Policy Issues for Review

13. **With no use of the CFF since 1999, it is natural to ask whether the facility provides a useful service for members of the Fund.** A four-year pause in use of the CFF may be too short to draw firm conclusions, but two possible explanations can be considered. The first possibility is that there is indeed less need for the CFF today, particularly in light of the evolution of other financing options. The second possible explanation is that the reforms to the CFF in 2000 made the facility overly restrictive, which has contributed to reduced demand, and that broader use of the CFF can be justified as consistent with the purposes of the Fund. If this is the correct interpretation, then options for relaxing some of the conditions of the CFF should be considered. This chapter considers both of these explanations.

A. Three Premises on which the CFF is Based—Do They Still Hold?

14. **The case for low-conditionality financing of balance of payments shocks through the CFF rests on three premises.** They are: (i) temporary shocks are common, and the appropriate response to such shocks consists of timely financing rather than adjustment; (ii) members have inadequate access to alternative sources of financing to cushion a temporary balance of payments shock; and (iii) other Fund facilities are not suitable for dealing with CFF-type shocks. These premises rest on weak foundations, as noted below, in

particular for middle-income countries. On the other hand, for low-income countries, financing options from the Fund as well as from other sources are more limited.

Temporariness of shocks

15. **Although in principle a temporary shock would argue for financing rather than adjustment, in practice it is often difficult to distinguish *ex ante* between the temporary and permanent components of shocks, and the appropriate response would typically entail some adjustment.** Empirical evidence suggests that, at least for commodity prices, there is a statistically significant downward trend, shocks around this trend are quite persistent, and the duration and depth of most shocks are hard to predict *ex ante* (see Box 2). Also, commodity price volatility has been increasing over time. Thus, most commodity price shocks would call for a mix of adjustment and financing, and the CFF may therefore not be a suitable instrument to deal with a large part of the shocks for which the CFF is mostly used. Volume shocks are more difficult to generalize, as they could reflect supply shocks of variable duration or demand shocks linked to the business cycle in partner countries.[11] Similarly, tourism shocks are also difficult to gauge, but can in some cases be short-lived. While the latter can be expected to be reversible eventually, their amplitude and frequency profile has varied widely over the last three decades. Furthermore, even a shock that is completely and rapidly reversed is likely to require some adjustment to ensure repayment of the compensatory financing. Such adjustment is particularly important for those countries that experience shocks frequently. Some other types of shocks, e.g. those arising from natural disasters, can be financed through emergency assistance, though this is an imperfect substitute (see below).

Alternative sources of financing

16. **While the premise that alternative sources of financing were not available may have held during the beginning of the period in which the CFF was in operation, since then global capital market integration has relaxed liquidity constraints for middle-income countries** (Figure 2). These countries, especially those that have an otherwise satisfactory balance of payments position, should be able to retain access to international markets when faced with a shock that is widely expected to be purely temporary and short.

17. **Low-income countries have access to official financing from other multilateral and bilateral creditors, especially for natural disaster shocks.**[12] Assistance for natural disasters has been rising over the last decade, and is provided largely in grants from bilateral donors and also in grant and loan form from multilateral agencies. Such assistance is important and can complement Fund compensatory financing, even if its targeted nature does

[11] See also "Fund Assistance for Countries Facing Exogenous Shocks" (SM/03/288, 8/11/2003).

[12] For a more detailed discussion, see "Fund Assistance for Countries Facing Exogenous Shocks," Chapter V and Annex IV (SM/03/288, 8/11/2003).

not render it applicable to all potential CFF-type shocks. The main other source of official financing specifically aimed at helping countries cope with commodity price shocks is the European Commission's FLEX mechanism. Established in 2000, it provides fast-disbursing budget support to countries coping with fluctuating export earnings. Hence, in cases where a commodity price shock has a substantial impact on the balance of payments but only a limited impact on the budget, the affected country is not eligible for financing under the facility.

Box 2. Recent Findings on Commodity Price Shocks

This box summarizes the main findings of recent research on commodity price shocks.[1]

- **Shocks to commodity prices tend to be persistent**. This is borne out both by studies focusing on individual commodities as well as on individual countries. The former type of investigation suggests that a majority of commodity price shocks have an average half-life of over five years. Studies that use individual countries as their sample typically focus on shocks to the aggregate terms of trade, and estimate similarly long-lasting shocks: a typical point estimate of the average half-life of terms of trade shocks (using panel estimation) is around six years. However, while the average half-life estimates are rather long, most studies report wide confidence intervals, suggesting relatively wide variation in price shock duration across commodities and countries. For instance, studies of terms of trade shocks suggest that for half of the sample of countries the half-life of such a shock tends to be less than four years, while for one-third the shock exhibits infinite persistence.

- **The duration and severity of commodity price shocks are essentially unpredictable.** The probability of a reversal of (or an end to) a commodity price slump appears to be independent of the length of time already spent in the slump; and the severity of commodity price slumps appears unrelated to their duration.

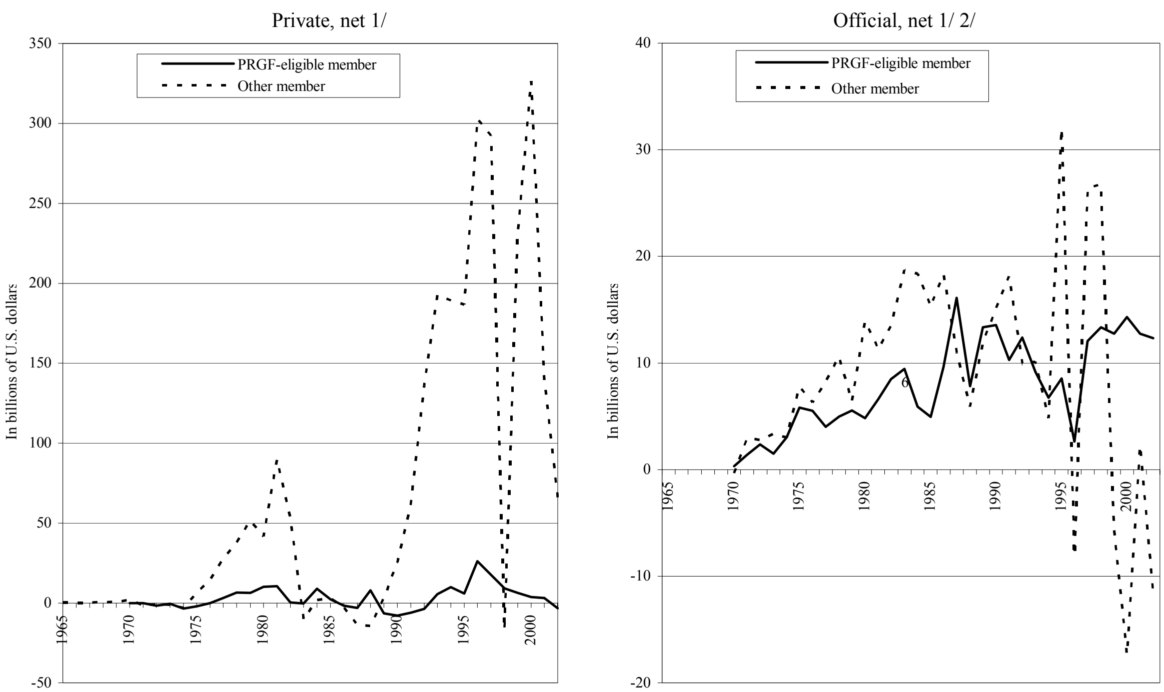
- **Commodity price cycles exhibit important asymmetries**. Research suggests that commodity price slumps tend to last longer than booms (4.2 versus 3.6 years on average, respectively), with the difference being statistically significant. Furthermore, statistical analysis of commodity price cycles suggests that their decline during the slump phase tends to be larger than their increase during the subsequent boom.

- **The volatility of commodity prices has tended to increase over time**. This tendency has been more pronounced after the mid-1970s, especially as regards large commodity price cycles.

- **Commodity prices have been trending down in real terms over time.** While this trend is dominated by commodity price cycles over short horizons, real commodity prices have been declining by about 1 percent a year on average. Formal statistical tests do not find evidence of significant breaks in this trend over time.

1/ See: Cashin, P., H. Liang, and C. J. McDermott, "How Persistent Are Shocks to World Commodity Prices?," *IMF Staff Papers*, Vol. 47, No. 2, 2000; P. Cashin, C. J. McDermott, and C. Pattillo, "Terms of Trade Shocks in Africa: Are They Short-Lived or Long-Lived?," IMF Working Paper 00/72, 2000; P. Cashin and C. J. McDermott, "The Long-Run Behavior of Commodity Prices: Small Trends and Big Variability," *IMF Staff Papers*, Vol. 49, No. 2, 2002; and P. Cashin, C. J. McDermott, and A. Scott, "Booms and Slumps in World Commodity Prices," *Journal of Development Economics*, Vol. 69, No. 1, 2002.

Figure 2. Capital Inflows



Source: World Economic Outlook.

1/ Excludes OECD members.
2/ Excludes net IMF financing.

18. **There are other mechanisms aimed at mitigating the effects of commodity price shocks, but they are typically not geared toward addressing balance of payments problems.** A recent development in the provision of insurance in low-income countries is the establishment of the International Task Force on Commodity Risk Management (ITF), led by the World Bank.[13] Still in an incipient stage, it is a public-private sector partnership to explore market-based approaches for assisting small-scale producers in developing countries to better manage their vulnerability to commodity price fluctuations.

Other Fund facilities for dealing with CFF-type shocks

19. **The Fund has an array of instruments for lending to middle- and low-income members in response to a shock, and several other options are under study.**

[13] For a fuller discussion of the ITF as well as other mechanisms to help countries cope with shocks, see "Fund Assistance for Countries Facing Exogenous Shocks," Appendix III, (SM/03/288, 8/11/03).

- **Access in the credit tranches,** which is normally provided under stand-by arrangements is available and can be readily tailored to deal with all types of balance of payments shocks, including temporary shocks of the type for which the CFF is intended. All members are eligible to request support under a stand-by arrangement, but the nonconcessional terms makes it ill-suited for low-income countries. Stand-by arrangements can be approved quickly, or augmented if already in place. An **extended arrangement** can also be augmented if an additional need arises.

- **The Poverty Reduction and Growth Facility** provides concessional lending to low-income members in support of three-year macroeconomic and structural adjustment programs. As noted in the companion paper, a PRGF arrangement can be augmented rapidly if the member's balance of payments increases due to a shock, and ways to provide greater clarity and systematization are proposed in that paper.

- **Two further options to help low-income members** suffering from shocks are presented in the companion paper, including subsidized purchases in the credit tranches under stand-by arrangements for PRGF-eligible members, and a stand-by-like window within the PRGF. Of these options, the staff sees the latter as the better approach, as it would avoid additional requests to donors for subsidized resources, and provide greater concessionality because of the longer maturity of repurchases.

- **Emergency Assistance for Natural Disasters** provides quick, non-concessional assistance to members afflicted by a major natural disaster—such as earthquakes, or hurricanes. Access is normally limited to 25 percent of quota. The member is required to provide a statement of policies, but upper credit tranche conditionality is not required. Emergency Assistance could be used in response to some supply shocks that could also qualify for CFF drawings, but would not be an option for price-related shocks. The possibility of subsidizing Emergency Assistance for natural disasters for PRGF-eligible members is discussed in the companion paper.

20. **Unlike stand-alone CFF purchases, most of the other lending instruments are associated with upper credit tranche-type conditionality.** The CFF is the only instrument that provides, by design, an option to deal with temporary shocks with a larger component of financing and less adjustment or conditionality. Experience shows, however, that member countries requesting CFF purchases are likely to have an underlying balance of payments problem, and thus CFF purchases would often need to be approved in conjunction with an upper credit tranche-type arrangement. Furthermore, stand-by arrangements can and should be tailored to deliver a mix of financing and adjustment that is appropriate to the problem at hand. To the extent that the shock is reversible, and there are no underlying balance of payments problems, the adjustment required under a stand-by arrangement can be minimal.

21. **Financing under the CFF does not count toward the access limits in the credit tranches and under the EFF, and hence CFF financing could, in principle, augment total resources available to members.** However, in practice, this floating aspect of the CFF has not been used to alleviate the constraint, since access in the credit tranches under stand-by arrangements and under extended arrangements rarely has been close to the access limits.

Out of 127 Fund arrangements that did not involve exceptional access (at approval) over the last ten years, annual access equaled 100 percent of quota in four instances, and in 18 more cases annual access exceeded 50 percent of quota. In no case since 1993 where a CFF purchase was approved in conjunction with a non-exceptional arrangement in the credit tranches did the combined access exceed the annual or cumulative access limits.

The role for a CFF

22. **In sum, the three premises on which the CFF rests are at best only partially satisfied, suggesting less need for the CFF.** Nevertheless, it is possible that further design changes are warranted to reinvigorate the CFF by, for instance, tailoring the instrument better for financing of low-income countries. The next section considers some options.

B. The Case for Further Redesign of the CFF

23. **It is worth considering whether there are changes in design that would be consistent with the purposes of the facility, and of the Fund more generally, and at the same time make the CFF more useful to the membership.** In particular, three kinds of options could be considered: (i) establishing concessional funding within the CFF to better help low-income countries dealing with shocks; (ii) broadening the coverage of the facility to include a wider range of imports; and (iii) reconsidering and easing the circumstances in which a stand-alone CFF purchase would be approved. These issues, which have been raised both by Fund members and outside agencies, are summarized in Box 3 and are discussed further below.

A concessional CFF

24. **For low-income members, even a purely temporary shock can inflict major and long-lasting damage, and force undue domestic adjustment.** At the time of the inception of the CFF, exogenous shocks, especially to commodity prices, were viewed as having a serious impact on a broad spectrum of the Fund's membership. Since then, many middle-income and emerging economies have diversified their export base, rendering them much less vulnerable to movements of individual prices. However, a large number of low-income countries remain reliant on a narrow range of exports, in many cases heavily dominated by a few primary commodities. Furthermore, cereals remain a large part of their consumption basket, and large changes in cereal prices have strong welfare and balance of payments implications.

Box 3. Reforms of the CFF Proposed in Other Fora

Inter-Agency Panel on Short-Term Difficulties in Financing Normal Levels of Commercial Imports of Basic Foodstuffs, organized by the World Trade Organization.

- **The Panel was established in 2001 in the context of the implementation of the 1994 Marrakesh Ministerial Decision** on the possible negative effects of the trade reform on least-developed and net food-importing developing countries (NFIDCs). The particular concern was that some of the developing countries which were highly dependent on supplies of subsidized food imported from the major industrialized countries might need temporary assistance to make the necessary adjustments to expected higher import prices for food as a result of liberalization, although output from their farming sectors could be stimulated by higher prices. The panel's members included representatives from UNCTAD, the International Grains Council, the Food and Agricultural Organization, the World Bank, and the Fund.

- **The tasks of the Panel included *inter alia*** an examination of the terms and conditions of existing facilities of the international financial institutions designed to help least-developed countries and NFIDCs facing short-term difficulties in financing normal levels of commercial imports of basic foodstuffs during periods of rising world prices.

- **In its 2002 report, with respect to the CFF, the Panel recommended that consideration be given to:**[1] (i) extending the product coverage of the facility to cover all basic foodstuffs; (ii) clarifying access in conjunction with an existing Fund arrangement; (iii) providing a greater degree of automaticity without requiring a parallel IMF-supported program; and (iv) reviewing the procedures and timeliness of disbursements.

Report of the Meeting of Eminent Persons on Commodity Issues, United Nations Council on Trade and Development (UNCTAD)

- **The objective of the 2003 meeting was to examine and report on commodity issues**, including the volatility of commodity prices and declining terms of trade and the impact these have on the development efforts of commodity-dependent developing countries.

- **The report of the group does not make recommendations directly concerning the CFF**, but it does recommend that UNCTAD and the Fund work toward designing a system of compensatory finance that has the following characteristics:[2] (i) automatic payouts linked to specific triggers; (ii) ease of access in terms of technical requirements; (iii) absence of conditionality; and (iv) the inclusion of a pass-through mechanism to producers and consumers.

1/ "The Report of the Panel," WTO, WT/GC/62-G/AG/13, June 28, 2002.
2/ UNCTAD TD/B/50/11, September 30, 2003.

25. **A concessional CFF could be considered to increase the ways for the Fund to respond to shocks in low-income countries, but other choices appear to be superior.** A concessional CFF, for example in the form of a subsidized interest rate on CFF drawings for PRGF-eligible members, would make the facility more suitable for low-income members, and broaden the pool of countries that might benefit from the facility. For instance, the rate of charge could be subsidized down to 0.5 percent for low-income countries, as with the PRGF,

while leaving the maturity unchanged.[14] Such a change would better align the options that are suitable for low- and middle-income countries. Even without considering how the subsidy element would be financed, there are some drawbacks to a concessional CFF:

- It is not clear that the CFF is the best instrument to allocate scarce concessional resources, and a mechanism that would permit the scarce resources to be used across a broader range of shocks and circumstances would be more efficient. Further, subsidized CFF purchases would still have only a small grant element, unless their maturity were increased, and augmentation under a PRGF would be more concessional.

- Many low-income members hit by shocks are likely also to have other balance of payments weaknesses, warranting some adjustment and conditionality. Drawings under the CFF would thus most often be made available in conjunction with an upper credit tranche-type arrangement. The options considered in the companion paper to increase the flexibility of the augmentation policy for PRGFs or to create a short-term window under the PRGF would provide more flexible and easily implemented financing options.

- As noted earlier, it is hard to predict the duration of price shocks, and they tend to be long-lived, contrary to the fundamental purpose of the CFF. Supply shocks are usually more clearly temporary, and for these, alternative financing is more readily available.

Broader coverage

26. **While most export items of the current account are covered by the CFF, coverage on the import side is restricted to cereals.** Expanding the coverage of the CFF's import component to include all basic foodstuffs—principally cereals (as now), basic dairy products, peas and beans, rice, vegetable oils and sugar—could be considered. As discussed earlier, the coverage of cereal import excesses in the CFF was added largely in response to humanitarian concerns. While the possibility of broader coverage of food was mooted at the time, it was noted that cereal imports accounted for a very large share of the calorie content of all foods imported by low-income countries, and that it would be easier to administer an element based on cereal imports alone.[15] So long as the cereal import element remains in place, there seems little reason in principle to argue against expanding this component to

[14] While financing options for a concessional CFF are not discussed here, one option would be to establish an administered account (funded by third parties) to subsidize interest payments on CFF purchases for PRGF-eligible members.

[15] See "Possible Fund Assistance to Members Adversely Affected by Higher Food Import Costs," (SM/80/177, 7/18/80). The share of the calorie content of cereal imports has since declined, but remains above half.

include other basic staples. However, data limitations remain likely to hamper the usefulness of such an expansion. Many countries cannot provide adequate data (for the CFF calculation) on cereal imports, and the situation is likely to be worse for other staples.

27. **Another suggestion is that balance of payments problems linked to trade liberalization could warrant compensatory financing, including through the CFF.** In particular, it has been argued that such financing would entail positive externalities for the global trading system, by strengthening incentives for individual countries to liberalize trade, unilaterally or in the context of multilateral trade negotiations. While some financing may indeed be welfare-improving, the CFF would not be the appropriate instrument to deal with the balance of payments costs of adjustment to permanent changes in relative prices and market access associated with trade liberalization. A proposal for a Trade Integration Mechanism (TIM) is currently being developed that would provide financing in the context of existing policies (credit tranches, EFFs, or PRGF arrangements) for short-term balance of payments needs arising from multilateral trade liberalization.[16]

Automaticity and looser conditions for stand-alone CFF purchases

28. **Easing the requirements limiting stand-alone CFF purchases that were introduced in 2000 could make the facility more automatic and would likely increase demand for the CFF.** The conditionality attached to CFF purchases could be reduced or eliminated by not requiring an "otherwise satisfactory balance of payments position" for stand-alone CFF purchases, perhaps by reinstating the tests of cooperation used previously.[17]

29. **However, staff considers that the changes made to the facility in 2000 provide an appropriate test for stand-alone CFF purchases.** The requirement that stand-alone CFF purchases be granted only when the balance of payments position is satisfactory apart from the temporary shock was the key change to the facility introduced in 2000. It sets the appropriate hurdle for low-conditionality financing to safeguard Fund resources, and thereby reduces the potential adverse selection problem, namely that the availability of relatively unconditional upfront purchases could bias the use of the CFF toward countries that are not prepared to pursue necessary adjustment policies. Therefore, staff believes stand-alone CFF purchases should continue to be limited to members whose underlying balance of payments position is satisfactory.

[16] "Fund Support For Trade-Related Balance of Payments Adjustments," forthcoming.

[17] Another idea that has been mooted would be to link financing to peaks in food import financing needs, independent of the overall balance of payments position. However, under the Articles of Agreement, members may only use Fund resources when there is an overall balance of payments need.

C. Concluding Thoughts

30. **Eliminating the CFF could be considered as a way to simplify the structure of the Fund's facilities by removing a facility for which the membership appears to have little need.** The fact that the facility has not been used since it was last reviewed, despite several large, relevant shocks, raises questions about its usefulness. Indeed, in the face of a shock that is widely perceived to be temporary, most middle-income countries should be able to attract private financing if they have adequate macroeconomic policies in place. If private financing is not available, they could seek support in the credit tranches under stand-by arrangements or, in some cases, under extended arrangements. Indeed, the credit tranches, particularly when provided under a stand-by arrangement, are very suitable to be used in the face of temporary balance of payments shocks. To the extent that the shock is expected to be reversible over a short time horizon, the associated policy adjustment under a stand-by arrangement would be less demanding.

31. **Low-income members are relatively more affected by shocks and have less access to market financing, and the Fund needs to be as able to support these members as it can the middle-income members.** For low-income members, the Board is considering options to clarify and systematize the Fund's financing for shocks. Greater flexibility in augmentation of access under PRGF arrangements and in particular a new short-term window under the PRGF Trust would underline the Fund's readiness to assist these members when they are hit by exogenous shocks. With such changes in the ways the Fund can assist low-income members—for whom shocks occur more frequently and typically inflict more hardship than for middle-income countries—it becomes harder to justify a separate instrument to assist middle-income members that experience shocks.

32. **At the same time, while the circumstances where the CFF would be used appear to be narrow, it still offers members a different mix of financing options, and the revisions made to the facility in 2000 provide adequate safeguards to the Fund's resources.** Even if the nature of the underlying shock is often difficult to gauge *ex ante*, recent experience suggests that members are confronted from time to time with shocks that are clearly exogenous and temporary. The CFF offers members the possibility of financing in the face of such shocks in a transparent way and with access additional to that under the credit tranche and EFF limits. For some members with otherwise strong balance of payments positions, the CFF offers the possibility of quick financing without the full conditionality attached to a Fund arrangement. The modifications to the facility introduced in 2000 have strengthened assurances that Fund financing will be used in an appropriate policy framework, and hence reduced the adverse selection problem and improved the safeguards to the Fund's resources. Therefore, just as abolishing the CFF would seem to come with little cost to the Fund or its members, the same applies to keeping the CFF.

33. **On balance, while there are clear arguments in favor of eliminating the CFF, staff does not see this as an urgent matter and can see some value in maintaining the facility in its current form while other financing instruments to help low-income member countries cope with shocks are being developed.** Another review of the facility could be scheduled after perhaps three years that would further assess the need for the facility

by the membership. The presumption would be that unless there is clear demand for the CFF by then, staff will propose that the facility be abolished.

V. Issues for Discussion

34. **In their discussion, Directors may wish to comment on:**

- How do Directors view the lack of use of the CFF in the last few years?
- Do Directors believe that the CFF remains a useful instrument or that it should be abolished?
- Do Directors agree that shocks in low-income member countries would be best addressed through the options presented in the companion paper rather than by subsidizing the rate of charge of CFF purchases by low-income members?
- Do Directors agree with the assessment that the current conditions for stand-alone CFF purchases should be maintained?
- If Directors prefer to retain the CFF, do they agree that the next CFF review should take place in three years? Should there be a presumption to eliminate the CFF at that time absent clear evidence that it is a useful instrument?

Analysis of the Southern African Cereal Import Shock

35. **The surge in cereal import costs and resulting food crisis in several southern African countries during 2002 and early 2003 constitute a distinct CFF-type shock in the period since the last review of the CFF.** The first signs of regional difficulties emerged in late 2001, when a decline in grain production in Zimbabwe, mainly caused by failed agricultural reform and general economic mismanagement, resulted in food shortages. The situation reached crisis proportions in the first half of 2002, as a severe drought in Zimbabwe, South Africa, and a few other neighboring countries resulted in a disastrous crop. The magnitude of this supply shock was quite severe, particularly for Zimbabwe and South Africa, the region's main grain producers, which were forced to raise their cereal imports by very large amounts. Thus, South Africa's 2002 cereal imports were 72 percent higher relative to 2001, whereas for Zimbabwe the corresponding increase was 617 percent.

36. **As a result of these developments, the entire Southern Africa region turned from a net grain exporter into a net importer, and the resulting increase in cereal prices compounded the direct impact of the supply shock.** As grain production in the main regional producers collapsed, countries that were previously importing grain from within the region were forced to turn to much more distant markets to satisfy their import needs. The associated higher transportation costs as well as the adjustment cost of shifting supply routes pushed up import costs substantially, adding to the direct impact of the supply shock.

37. **The overall impact of the shock, both in human and in economic terms, on several countries in the region was severe.** Table 1 summarizes the initial estimate (as of July 2002) of this impact on the countries that were affected most in terms of population at severe famine risk, additional cereal import requirements, and humanitarian assistance sought from multilateral and bilateral donors.[18] The table also includes two eastern African countries (Eritrea and Ethiopia) which experienced similarly severe drought conditions but were affected to a smaller degree by the price component of the shock.

38. **For most countries concerned, the estimated cereal import excess resulting from the shock was near or above the CFF access limit.** According to the above initial estimates (but excluding the member least affected, Mozambique), the projected cereal import excess ranged from 20 percent of quota (Swaziland) to 142 percent of quota (Malawi), for a regional average of almost 70 percent of quota. Even on the assumption that the humanitarian assistance sought would be disbursed in full, the regional financing need would average 45 percent of quota, just at the CFF access limit—but leaving four members (Eritrea, Ethiopia, Malawi, and Zimbabwe) with a residual financing gap—and well above the normal access limit under emergency assistance.

[18] These are initial estimates made by Fund staff at the time when they were beginning to explore with the respective country authorities possible options to address the crisis.

Table 1. Impact of the Cereal Supply Shock

Member	Population at severe risk (in percent of total population)	Additional cereal import requirements (percent of quota)	Humanitarian assistance sought (percent of quota)
Eritrea	25	71	20
Ethiopia	20	64	14
Lesotho	20	68	25
Malawi	28	142	57
Mozambique	3	5	--
Swaziland	21	20	5
Zambia	21	26	9
Zimbabwe	46	89	41
Average	**23**	**61**	**21**

39. **In the event, these initial estimates of cereal import excess and available financing proved optimistic.** By end-2002 or early 2003, it became clear that the cereal import excess for the region as a whole would probably be double what was originally envisaged, for several reasons.[19] First and foremost, the full impact of the shock on import prices had not been fully incorporated in the original projection. Second, there were growing indications that HIV/AIDS (with a rate of infection of up to a third of the adult population in some of the countries concerned) was creating a vicious circle in the presence of the famine crisis: infected individuals became more susceptible to disease due to inadequate nutrition, which in turn made them less capable to engage in farming activities. Third, a number of agricultural support schemes did not have the anticipated results. At the same time, it became apparent that humanitarian assistance was falling well short of the amounts sought by the authorities: out of a total $611 million sought, only $286 million eventually materialized.

40. **Under these circumstances, Fund staff intensified their discussions with the authorities on Fund financing options, or alternative strategies to cope with the deteriorating situation.** Table 2 summarizes the status of relations with the Fund of the members concerned at the time of the crisis, the types of options considered, and the strategy eventually adopted.

41. **Fund staff discussed with the authorities a variety of options, including the CFF, Emergency Assistance (where applicable), or augmentation of existing PRGF arrangements.**[20] In all cases where the CFF was raised as a possibility (Eritrea, Ethiopia, Lesotho, Zambia), the authorities ruled it out on account of its non-concessional nature. In

[19] See "Joint Statement on the Food Security Situation in Southern and Eastern Africa" (FO/DIS/02/259, 12/13/2002)

[20] The exception was Zimbabwe, which was already in arrears to the Fund, and a declaration of non-cooperation had been adopted in June 2002.

other cases (Eritrea, Lesotho, Zambia), the authorities were also reluctant to agree on an Emergency Assistance drawing on the same grounds.

Table 2. Response to the Cereal Shock

Member	Fund relations	Options considered	Strategy adopted
Eritrea	-	CFF, Emergency Assistance	World Bank support, use of reserves
Ethiopia	PRGF-supported program	CFF, PRGF augmentation	PRGF augmentation (10 percent of quota)
Lesotho	PRGF-supported program	CFF, Emergency Assistance, PRGF augmentation	Use of reserves
Malawi	PRGF-supported program (off-track)	Emergency Assistance	Emergency Assistance (25 percent of quota), World Bank support, use of reserves
Mozambique	PRGF-supported program	PRGF augmentation	Domestic adjustment
Swaziland	-	-	Domestic adjustment
Zambia	PRGF-supported program	CFF, Emergency Assistance, PRGF augmentation	PRGF augmentation (5 percent of quota), World Bank support
Zimbabwe	Declaration of non-cooperation adopted	-	Use of reserves

42. **Additional Fund financing was agreed with three of the members concerned.** An augmentation of existing PRGF arrangements was provided to Ethiopia and Zambia (at 10 and 5 percent respectively)—in the case of Zambia, Fund financing was supplemented by World Bank support. In the case of Malawi (the member most adversely affected), an augmentation was not an option as the program was off-track, and the authorities opted instead for Emergency Assistance, at 25 percent of quota.[21] Given the magnitude of the Malawi shock, however, and despite some World Bank support, most of the higher import bill was financed through use of reserves.

43. **In a few cases, the authorities were reluctant even to agree to a PRGF augmentation, even though they qualified for it.** The members in question (Lesotho and Mozambique) cited concerns with the public debt ratio, either in terms of its overall level or its external/domestic composition. In the case of Lesotho, given its comfortable foreign exchange reserve position, it was agreed to finance the higher import bill by drawing down reserves below the program floor. On the other hand, Mozambique and Swaziland chose to undertake further fiscal adjustment to preserve their foreign exchange reserve position in the face of the shock. Offsetting domestic adjustment was also chosen by two other southern African countries (Botswana and Namibia), where the impact of the shock was much smaller.

[21] At the time of the discussions, the first review had not yet been completed.

The Shock of September 11, 2001

44. **In the aftermath of 9-11 several countries in the Caribbean, the Middle East and North Africa experienced sharp declines in tourism receipts—a shock that was exogenous and expected to be temporary.** This shock provides an opportunity to examine how the Fund, and the concerned members more generally, dealt with the temporary increase in these countries' balance of payments need.

45. **For 19 member countries in the Caribbean, the Middle East, and North Africa, for whom the tourism sector is a major source of foreign exchange receipts, the initial estimates for the increase in the balance of payments need in 2002—due to 9-11—averaged about 60 percent of quota** (Figure 1).[22] The July 2001 World Economic Outlook projections for 2002 did not, on average, envisage export shortfalls for these 19 members of a magnitude that would have qualified for compensation under the CFF. On the contrary, rather than a shortfall, the projections showed an export excess amounting to 16 percent of quota (0.3 percent of GDP) on average. The 9-11 led to substantial revision to the projections and the December 2001 WEO projections showed an export shortfall equal to 62 percent of quota (1.1 percent of GDP) on average for these 19 member countries. In subsequent WEO projections (March and July 2002), the projected export shortfall for 2002 declined somewhat, but remained at around 50 percent of quota (0.8 percent of GDP).

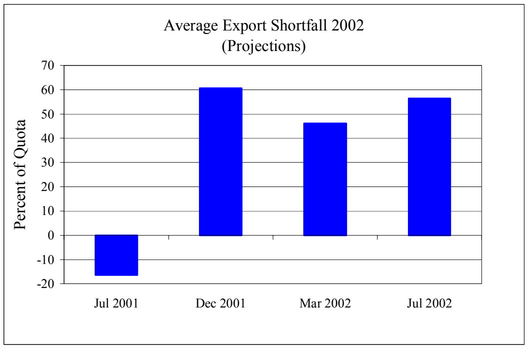
46. **Some countries considered requesting support under the CFF.** In many cases, a stand-alone CFF purchase was ruled out, as the balance of payments position of the members apart from the export shortfall was not judged to be satisfactory. In some other cases, discussions were initiated but not completed on a Fund-supported program which could have included access under the CFF. In a few cases where a stand-alone CFF purchase could have been considered, the authorities did not express interest and rather sought and received assistance from other international financial institutions, partly because they wished to avoid the stigma of requesting Fund support. One member (Tunisia), which could have qualified for a stand-alone CFF purchase, absorbed the loss of tourism receipts through a tightening of fiscal and monetary policies and privatization-related FDI inflows.

47. **Five countries in the sample are PRGF-eligible, of which three had a Fund arrangement at that time** (Kenya and Tanzania a PRGF, and Sri Lanka a stand-by arrangement). However, in the case of Kenya, the program was off track during 2001-2002, precluding augmentation. In Tanzania, a high level of reserves allowed financing of the shock without recourse to Fund financing. Sri Lanka could have been eligible for CFF resources in conjunction with its stand-by arrangement. However, that arrangement had been

[22] The 19 countries are: The Bahamas, Barbados, Dominican Republic, Grenada, St. Lucia, St. Vincent and the Grenadines, Costa Rica, Guatemala, Egypt, Israel, Morocco, Tunisia, Jordan, Turkey, Kenya, Tanzania, Maldives, Seychelles, and Sri Lanka.

48. intended as a bridge towards a PRGF, and the authorities decided not to request CFF resources.

Figure 1. September 11 Shock: Projected Export Shortfall in 2002



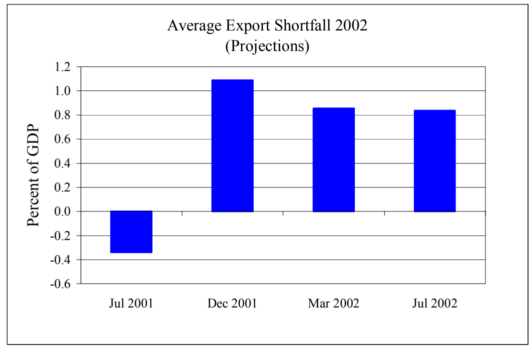
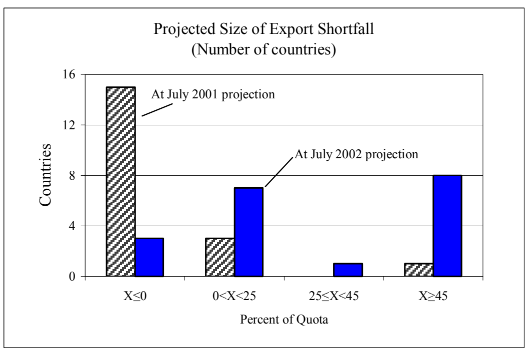
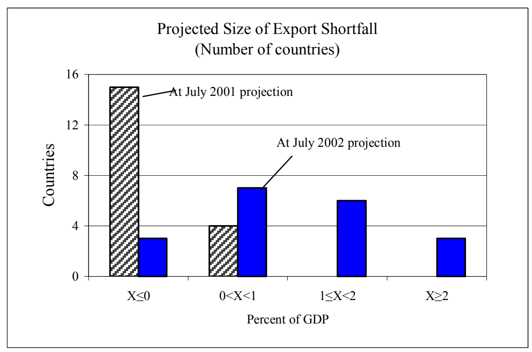


Figure 2. September 11 Shock: Number of Countries and Size of Projected Shortfall





Source: World Economic Outlook, and Stand-By Operations Division, PDR.

CFF—Criteria to Determine A Satisfactory Balance of Payments Position

Member countries may make purchases under the Compensatory Financing Facility (CFF) either in the context of a Fund arrangement, or stand-alone if the member's BOP position is satisfactory apart from the effect of the CFF-eligible shock. This note sets out the history of the concept of an otherwise satisfactory BOP, and proposes some criteria for identifying such a position.

A. Recent Amendments to the CFF

49. **Stand-alone CFF purchases continue to be possible under the current CFF as revised in November 2000, but they require an otherwise satisfactory external position.** CFF resources can now be used in two situations: (i) when a Fund arrangement exists (or is being requested); or (ii) when the member's balance of payments position, apart from the effects of the CFF-related shocks, is *satisfactory* (a stand-alone CFF purchase). In the first case, tranching of CFF resources was introduced, to be provided in conjunction with the phasing under the arrangement, linking CFF purchases to formal conditionality for the first time since the facility was introduced in 1963. In the second case, a purchase is allowed up to the access limit for CFF purchases and is not linked to conditionality under an upper credit tranche arrangement. At the same time access limits were simplified.[23] No CFF purchase has been made since the new provisions of the CFF were introduced in November 2000.

B. History of "Satisfactory Balance of Payments"

50. **The concept of a *satisfactory* balance of payments position has a long history**. The concept was introduced in 1983 in the context of strengthening then-existing cooperation criteria, which in turn determined the level of access under the CFF. In order for a member to have a higher CFF access (the upper tranche, according to the terminology of the time), the existence of a *satisfactory* balance of payments position was a condition (presumably a sufficient condition) to provide evidence of cooperation.[24] The use of the satisfactory balance of payments concept was changed somewhat at the time contingency financing was added and the facility was renamed as the CCFF. The concepts of cooperation and satisfactory balance of payments were made independent. Higher CCFF access was available to those members that had a satisfactory balance of payments without any reference to cooperation.

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[23] "Amendments of the Compensatory Financing Facility" (EBS/00/215, 11/3/2000).

[24] Other criteria for cooperation included the existence of, and broadly satisfactory performance under, an arrangement from the Fund, or the approval of such an arrangement at the time the request for a CFF purchase was made. See "Requirements of Cooperation Under the Compensatory Financing Facility" (EBS/83/171, Sup. 1, 9/12/1983).

51. **A general definition of satisfactory balance of payments was elaborated in the 1993 operational guidelines.** This was an economy with a strong external position, adversely affected by exogenous and quickly reversible shocks like a temporary decline in world prices or a drought. The shortfall needed to be considered to be self-correcting and no fundamental change in economic policy would be warranted.[25] Staff were left to interpret this relatively broad formulation, which has not been reassessed since that time.

52. **In the period since the introduction of the concept of a satisfactory balance of payments position, only one purchase was made on the basis of those criteria.** During the period 1983-2001, 115 purchases amounting to SDR 15.6 billion were made. Of these, only one CFF purchase was based on a satisfactory balance of payments—allowing Jordan to access the "upper tranche" provision applicable in 1985. The staff report states that, apart from the temporary effects of the conditions that have given rise to the proposed purchase under the CFF, Jordan's balance of payments position was satisfactory.[26] Fund credit outstanding to Jordan was zero at the time.

C. Criteria for a Satisfactory Balance of Payments Position

53. **The Fund can only allow members to purchase when there are adequate safeguards for the temporary use of its resources.** Experience has shown that most countries requesting CFF purchases have other balance of payments problems, and thus it is expected that many CFF purchase requests will be accompanied by an upper credit tranche arrangement with the necessary adjustment policies to safeguard the Fund's resources. However, in some cases the member's balance of payments position may, apart from the shock, be satisfactory, and thus the Fund may have sufficient confidence that adequate safeguards are in place without recourse to an upper credit tranche arrangement.

54. **Decisions on what constitutes an otherwise satisfactory balance of payments position thus derive from the need to safeguard Fund resources.** The conditions need to be strict enough to safeguard Fund resources and to ensure uniformity of treatment among the membership. Conditions are set out below, which will necessarily involve judgment according to each member's situation:[27]

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[25] "The Compensatory and Contingency Financing Facility (CCFF)—Operational Guidelines" (SM/93/147, 7/3/1993).

[26] "Jordan—Use of Fund Resources—Compensatory Financing Facility—Fluctuations in the Cost of Cereal Imports" (EBS/84/265, 12/20/1984).

[27] Conditions for a satisfactory balance of payments position described below elaborate on the definition in the 1993 Operational Guidelines.

- ***A satisfactory balance of payments apart from the shock.*** The most recent Article IV consultation will be one source of information to consider the following necessary elements:

    - A satisfactory balance of payments position prior to the shock. This judgment based partly on standard measures of vulnerability including reserve cushion, external debt profile and ratios, current account deficit, credit rating. Also, the member must not have had a balance of payments need requiring recourse to exceptional financing (drawings from the Fund, or arrears).[28]

    - A viable medium-term balance of payments position, such that absent the shock, the current account deficit is manageable and the debt profile is either stable or improving over time. Evidence of a sustainable fiscal position should also be confirmed to avoid domestic imbalances spilling over into the balance of payments.

- ***A post-shock strategy to maintain medium-term sustainability that does not require fundamental policy changes.*** Members seeking financing under the CFF will discuss with Fund staff the size of the shock and their expected response—the mix of policy adjustment and financing to maintain medium-term sustainability. In cases where the identified financing (including a reasonable reserve loss) is enough to cover the temporary export shortfall or the cereal import excess, then the shock could be dealt with mainly through financing. In cases where the shock is larger, adjustment will be necessary. Such adjustment would not prevent a country from being considered as having a satisfactory balance of payments for the purposes of the CFF, unless a "fundamental" change in policies is needed. A fundamental change would include policies involving a substantial fiscal or exchange rate adjustment, or other policies with similar impact on domestic absorption. If such changes are required to maintain medium-term sustainability, then CFF access should be made available in more than one purchase linked to the conditionality under an upper credit tranche-type arrangement.

[28] A member with a staff monitored program for track record purposes would be presumed to have other balance of payments difficulties. A staff monitored program for signaling purposes may also indicate a less-than-satisfactory balance of payments position, as it indicates that other lenders consider the situation requires Fund monitoring.