INTERNATIONAL MONETARY FUND

Review of Contingent Credit Lines

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In Consultation with Other Departments

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EXECUTIVE SUMMARY

The Contingent Credit Line was intended to help member countries with strong policies confront the challenges of more integrated capital markets by providing assurances of Fund support in the event of financial market pressures due to external events and to reinforce the incentives for strong policies. The initial experience with the CCL suggests that, as presently designed, it is unlikely to meet those objectives. This review of the CCL considers whether a redesign of the facility could make it an effective instrument of surveillance and crisis prevention.

A number of factors have discouraged use of the CCL: potentially eligible countries were not confident that a CCL would be viewed as a sign of strength rather than weakness; they were concerned about the risk of negative fallout if they were to be considered ineligible at a future date; there has been uncertainty whether Fund resources under a CCL would in fact be available in the event of need; and many potentially eligible countries have reduced their vulnerability to external shocks through reserve accumulation, the adoption of flexible exchange rates, and other reforms, reducing the perceived demand for insurance in the form of a CCL.

The paper examines a range of options and design modifications to the CCL to address these concerns. The potential changes to the CCL, include (i) more explicit eligibility criteria, while preserving an appropriately high standard for policy; (ii) a more systematic process for periodic assessments of eligibility, independent of a request by the member, with the possibility of a published list of prequalified members; (iii) expanding the circumstances in which CCL may be requested and/or drawn; and, (iv) greater automaticity, without undermining the necessary safeguards for Fund resources.

This review presents three broad options:

- First, based on redesigned CCL eligibility criteria, a published, prequalification regime. This new facility would include clearer, less discretionary, eligibility criteria, a Board endorsed list of qualifying countries, signaling the Fund's willingness to provide CCL resources, streamlined procedures for activation, and some broadening of the circumstances in which the CCL would be available.

- Second, a redesigned CCL, with all the elements of option one, absent a published list of prequalified countries. In this model, the focus of the reform would be on strengthening the surveillance process by conducting in the context of the Article IV process a graduated assessment of vulnerability, using the proposed new framework of CCL eligibility criteria. This would give greater clarity to Fund members about the policy thresholds that would be necessary to obtain a CCL, without the disadvantages of a more explicit public rating framework by the Fund.

- Third, to allow the CCL to expire in November 2003 and focus surveillance more effectively to evaluate vulnerabilities of emerging market economies. At the same time, improvements can be made to other existing facilities to ensure that the Fund has adequate instruments to respond quickly and effectively to capital account pressures faced by member countries with strong policies. Should the Board choose this option, there is scope to modify high access precautionary arrangements to make them more effective in crisis prevention and more attractive to potential vulnerable members.

I. Introduction

1. **The Fund continues its efforts to strengthen the effectiveness of surveillance, particularly with regard to crisis prevention, and to improve its capacity to help support member countries confront the challenges posed by more integrated capital markets and globalization more generally.** Building on the changes in the operations of the Fund put in place over the past several years, we are exploring ways to encourage member countries to adopt stronger and more resilient policy frameworks, to build firmer and deeper financial cushions, and to respond faster to financial pressures.

2. **This review of the Contingent Credit Line (CCL) considers whether a redesign could make it a more useful facility.** Section II of the paper summarizes the objectives of the facility and recounts recent experience; section III briefly reviews the main factors accounting for the lack of use of the CCL to date; section IV reviews various specific proposals to address the identified problems; section V presents a range of options for modifying the facility and other options for achieving some of the objectives of the CCL; section VI concludes with issues for discussion

II. Experience With the CCL

3. **The Fund first considered a special facility for helping members with strong policies deal with financial market volatility in the early 1990s.** Against the backdrop of the speculative attacks on exchange rate pegs of the early 1990s, a Short-Term Financing Facility (STFF) was discussed by the Board aimed at Fund members particularly vulnerable to large swings in capital movements induced by external conditions.[1] The idea was that members would be able to draw on Fund resources without conditionality through the STFF if they had fundamentally sound economic policies and prospects but faced very short-term external pressures, stemming from events largely outside their direct control, that seemed likely to reverse or dissipate relatively quickly. The proposal was not adopted because of a range of concerns about the difficulty of assessing when markets have misjudged a particular country's policy stance, the risks of using Fund resources in the context of severe financial pressures without a framework of conditionality, as well as concerns about substituting Fund resources for other available short-term facilities. These concerns are similar to those that have underpinned debates in the Fund on the role of the standalone compensatory financing facility, and they anticipated many elements of the debate on the CCL.

4. **The proposal for a contingent credit line surfaced in the fall of 1998 after the Asian financial crisis, and Russia's default and introduction of capital controls in August 1998.** The repercussions of these events touched almost all emerging markets. The

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[1] See: *Short-Term Financing Facility* (EBS/94/193) and the *Concluding Remarks by the Chairman—Short-Term Financing Facility* (BUFF/94/112).

concern was that the globalization of capital markets coupled with swings in investor risk appetite may lead to capital market pressures not resulting from weaknesses in domestic policies but from “contagion”.

5. **In this context, the CCL was designed to achieve two principal objectives:**

- To provide assurances to members with demonstrably sound policies that Fund resources would be readily available in the event of financial market pressures due to external events.
- To create further incentives for the adoption of sound policies and stronger institutional frameworks.

6. **The CCL has several features that distinguish it from other Fund facilities**:

- Specific eligibility criteria prescreen members, providing *ex ante* conditionality.[2]
- Access to Fund resources is available only to meet exceptional financial pressures in the capital account due to contagion.
- Part of the CCL would be available in the event of a shock, subject to Board approval, but without formal performance criteria or necessarily a change in policies.

The main provisions of the CCL can be illustrated by a timeline of the steps necessary to use the facility (Figure 1) and the eligibility criteria and review procedures are summarized in Annex I.

7. **In the Board discussion surrounding the adoption of the CCL, Directors raised a number of questions and concerns that have informed the subsequent debate.**[3] How high or selectively should eligibility criteria be set? What types of risks and shocks should a contingent line of credit be designed to help insure against? How could the Fund provide a reasonable assurance of access to the facility in the event of contagion without putting Fund resources unduly at risk? Can eligibility criteria be set with sufficient assurances that upfront access to potentially large amounts of Fund resources could prudently be provided without the usual Fund conditionality? Would precautionary arrangements provide a better means of

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[2] All members are eligible to use the General Resources of the Fund, unless declared ineligible. This paper uses the term “eligibility” or “CCL-eligible” more narrowly to denote that a member has met the facility-specific eligibility criteria.

[3] *Summing Up by the Chairman Contingent Credit Lines*, BUFF/99/56, April 23, 1999

Figure 1. Timeline for Request and Use of a CCL

(under existing framework)

Preparatory Steps T= before Board

Preliminary **eligibility assessment** by staff based on previous year Article IV assessment and recent financial data to determine whether a sufficient critical mass of factors relevant to the eligibility criteria are in evidence.

Staff visit/Article IV. Discussions of a CCL request and preparation of Board documentation.

Board Discussion of CCL Request T= 0

Request for arrangement and formal eligibility assessment. A members' request for support under a CCL is made in circumstances where a member is not facing prospective exceptional pressures on the balance of payments, nor has a present need for Fund resources, with a quantified quarterly framework, in conjunction with the **assessment of eligibility**.

Mid-Term Review T=6 months

Board updated on macroeconomic and financial developments and other issues bearing on eligibility. If needed, a supplement to the letter of request.

Renewal or Exit T= 12 months

CCL can be renewed for 12 months with a new letter of request, or the CCL commitment will lapse.

Activation Review (at any time)

T= exceptional pressures on capital account

Board to ascertain that the circumstances of contagion are present and largely beyond the members' control to make available associated purchase, normally one-third of total access.

Post-Activation Review.
T= shortly after activation review

A review, normally following the activation with a short lag, serves to determine the phasing and conditionality for the remaining resources.

supporting members facing the types of risks that motivated the CCL?[4] The balance among these competing considerations struck in the initial CCL set relatively stringent, but still generally defined eligibility criteria, and to further condition access to the activation tranche on a Board review.

8. **There were no requests for the CCL as originally designed. In November 2000, in view of that initial experience and a number of concerns with the design of the facility, the CCL was modified**. The principal modifications were:[5]

- **Less intensive initial monitoring arrangements than other Fund arrangements**: the requirements for performance criteria, quantitative and structural benchmarks, and a technical memorandum of understanding were explicitly eliminated, and the Boards' role in the mid-term review was circumscribed.[6]

- **Simplified conditions for the activation review to enhance automaticity.** The activation conditions were relaxed with the elimination of the requirement that "the member has successfully implemented the economic program that it had presented as a basis for its access to CCL."

- **Reduced rate of charge and commitment fee**. The initial surcharge was reduced from 300 to 150 basis points, rising over time to 350 basis points giving a 150 basis point cost reduction compared to the SRF. The commitment fee was lowered from 25 basis points to 10 basis points for amounts committed in excess of 100 percent of quota, as applied uniformly to all arrangements above 100 percent of quota, including the SRF.

9. **Following these modifications, the staff conducted an assessment of eligibility across a section of the membership of the Fund.** Specifically, the staff conducted in-depth assessments of 15 members against the eligibility criteria. Of these, 7 members were considered at one or more points to be potentially eligible. Several other emerging market economies that might have been considered possible candidates were considered not to meet the substantive criteria set out in the CCL. The staff initiated discussions with the potentially eligible candidates. During the period since the 2000 modifications, two of the members

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[4] All arrangements in the General Resources Account (GRA) are precautionary by nature. The use of the term precautionary in this paper refers to arrangements where the member has expressed its intention not to make purchases. This statement is not a binding commitment and an arrangement retains its character as an instrument to provide a member with an assurance of access to Fund resources should the need arise (subject to meeting the specified conditions).

[5] See: *Review of Fund Facilities—Preliminary Considerations,* EBS/00/37; *Review of Fund Facilities–Further Considerations*, EBS/00/131; *Follow-Up*, EBS/00/187; and, *Summing Up by the Acting Chairman*, BUFF/00/175.

[6] Monitoring and conditionality would be strengthened in the post-activation phase of a CCL.

considered strong candidates expressed qualified interest in a possible CCL request. One of these countries (Mexico) came close to making a CCL request, but subsequently decided not to pursue it in part because of concerns that the CCL would exacerbate upward pressure on its exchange rate.[7] Three members inquired about potential eligibility but were not judged, at the time, to meet the requirements.

III. Factors Affecting Take-Up of CCL

10. **A number of factors seem to account for the lack of interest in the CCL.** On the basis of the assessments offered by a broad range of policy officials and financial market participants,[8] the most important of these factors related to: concerns associated with the signal conveyed by a request for a CCL ("entry problem"); the uncertainty created by the prospect of withdrawal of eligibility ("the exit problem"); the application of the eligibility criteria; insufficient automaticity; the changing external environment and its impact on the demand for contingent credit; and other factors.[9] These factors present a useful basis for evaluating alternative modifications to the CCL and the merits more generally of extending the facility itself. They need to be considered against the background that many members remain skeptical of the merits of a CCL, and believe that modifications that weakened safeguards unduly would not be appropriate.

11. **Many concerns associated with the design of the CCL relate to the risks associated with the entry and the exit problems.** Many potentially eligible countries have expressed concern that a CCL request might be perceived negatively, both domestically and externally. This stigma concern is related in part to the general concern associated with an approach to the Fund for financial support. Such a request, even from a member with quite strong perceived fundamentals, could convey a signal of greater underlying vulnerabilities by the member than the market previously perceived—asymmetric information. These risks may be magnified because determination of eligibility is essentially undertaken only in the context of a request by a member, rather than on the basis of a systematic, published assessment of members' policy frameworks. This adverse signal from a CCL request could be compounded, in the view of some members, by the risk of association with other users of the CCL that may have even greater perceived vulnerabilities. The expectation that the universe of potential candidates might be limited to emerging market economies, further added to this concern.

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[7] The Mexico 2002 Article IV consultation reports (SM/02/160 and SM/02/89) detail much of the analytical work carried out for an assessment of CCL eligibility.

[8] Annex II summarizes key published proposals to modify the CLL and reports on outreach discussions with country officials and with private sector participants. In addition, there was an informal Board meeting on the CCL on November 26, 2002.

[9] The issues are similar to members' views on the CCL in the context of the 2000 review of Fund facilities (see Annex IV, EBS/00/131).

12. **Exits from a CCL were also viewed as difficult.** Termination of a CCL owing to a determination of ineligibility would likely be read by markets as indicating a deterioration in a member's policies and accordingly would likely increase its risk premium. Potentially eligible members were also worried that non-renewal of a CCL by the members could be perceived by the markets as symbolizing weaknesses rather than strength. More generally, there has been concern that exits would catch markets by surprise. These concerns about the "exit problem" may be more significant in a regime where the conditions for eligibility are somewhat generally defined, and conditions for exit are not explicitly defined.

13. **In addition, some members have suggested that the CCL eligibility criteria have been interpreted too narrowly or too stringently**. Some members have suggested that less emphasis should be placed on the magnitude of a member's reserves in the context of a flexible exchange rate regime, relative to other dimensions of financial strength. Others have suggested that limiting the facility to a somewhat narrowly defined type of external shock was excessively constraining. They argued that economic shocks typically mixed current and capital account features, which in any event would be difficult to disentangle and would require a common policy response.

14. **Another problem identified by some members and by market participants was the lack of full "automaticity"—reducing confidence that resources from the Fund would be available in the event of a need.** The requirement for separate Board approval prior to a purchase of the activation tranche created some uncertainty about whether and when Fund resources would be made available. The perceived complexity of the procedures around eligibility, activation and disbursement—illustrated by the chart above—reinforced this concern.

15. **The decline of perceived risks from contagion, and heightened country defenses may have also contributed to the lack of demand for the CCL:**

- Markets seem to have become more discriminating. The high degree of cross-country correlation of financial market returns that was associated with the financial contagion during the Asian crisis and Russia's default has since moderated significantly.

- Emerging markets have also adopted strategies to self-insure against financial contagion. Some emerging market economies have opted for significant reserve accumulation, especially in relation to short-term debt obligations; several likely CCL eligible members have shifted to more flexible exchange rate arrangements; others see EU accession and convergence as a sufficiently positive signal of their policies' strength.

- The level of access under the CCL that is available at the time of activation may not provide meaningful additional insurance against a financial crisis to those members that already hold substantial international reserves, particularly in light of potential access to the Fund's resources under the Supplemental Reserve Facility (SRF).[10]

16. **Other features of the CCL may also have contributed to reducing its attractiveness.** These problems do not appear to be as significant as those identified above, but they have been noted by some as disincentives. These features include: the size of the commitment fee, which some consider excessive in light of the very limited risk that the resources will be purchased; the level of surcharges relative to those in resources in the credit tranches;[11] and the 12-month limit for a CCL arrangement.

IV. Potential CCL Design Modifications

17. **These problems suggest that the CCL is not viable in its present form, either as a compelling source of contingent financial support, or as a particularly powerful incentive to strengthen policies and reduce vulnerability to crisis.** This section explores a menu of design modifications that might offer the prospect of a more effective facility. This menu has been informed by extensive discussions with officials and market participants. In particular, two outreach discussions took place during November-December 2002, with several country officials from potential users as well as Fund creditors, and with financial market representatives. There was also an informal session with Executive Directors in November 2002.

18. **The modifications considered address four issues;**

- The substantive criteria for eligibility;
- The process for assessing eligibility;
- Automaticity and the circumstance test; and
- Other design features, such as charges and maturity.

These changes can be considered independently of each other or in combination. What is important is their overall impact and the extent to which they would offer a meaningful improvement in crisis prevention by strengthening surveillance, encourage the adoption of sound policies and more robust institutional structures, and offer precommitted financial support to complement the Fund's other financial facilities.

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[10] For four of the seven members considered likely-eligible candidates for the CCL, the activation purchase of up to 167 percent of quota would have augmented reserves on average by almost 12 percent, and the other three fall within a range from a low of 3 percent to a high of 20 percent.

[11] If fully utilized, a CCL with 500 percent of quota would have an average surcharge of 150 basis points in the first year compared to an average surcharge of 100 basis points for resources in the credit tranches of the same magnitude assuming a member has no outstanding Fund credit at the outset of the arrangement.

A. Substantive Criteria for Eligibility

19. **The eligibility criteria are a critical feature of the CCL.** In exploring ways to improve the existing facility, the staff considered a range of possible options framed by two objectives. The first was to define the substantive threshold for eligibility at an appropriately high level. This level would be set to avoid the risk that by providing a CCL the Fund would validate a policy framework that proved fragile or unsustainable, but not set so high as to find any source of potential vulnerability as disqualifying. The eligibility criteria should focus on those factors that are critical for sustainable policies and that provide reasonable cushions against possible adverse outcomes.

20. **The second consideration was to clarify the eligibility criteria by making them more objective while retaining scope for exercising judgment.** More objective criteria would enhance incentives for members to adopt the needed policies and institutional frameworks actions to achieve and to maintain CCL eligibility. Staff considered a pure rules-based framework.[12] With transparent objective criteria coupled with appropriate data provision, market participants could anticipate changes in CCL eligibility, lessening the element of surprise. Further, the integrity of the list would not be in question as no scope would exist to modify the list in response to lobbying efforts and political pressures. However, standardized, rules-based criteria would be difficult to devise given the complexity of the policy and economic circumstances of our members. Since some issues are not amenable to objective criteria; rules may not capture unforeseen vulnerabilities; and may not be directly comparable across countries because of varying statistical practices. For these reasons, the criteria would need to be framed so as to preserve a necessary degree of judgment to allow assessments of policy fundamentals across countries in different economic circumstances, with different records of policy credibility, and at different starting points.

21. **In view of these considerations, the staff developed a framework of substantive criteria for assessing eligibility.** These criteria, which are described in Annex III, focus on areas of fiscal, monetary and exchange rate policies, debt and external sustainability, financial sector soundness, data adequacy, and institutional strength.[13] Indicative thresholds would be set to define a reasonable cushion against shocks but not so high as to exclude the possibility of future vulnerability. The substantive standard would be designed to be broadly equivalent to that established in the existing CCL, but by defining the criteria more explicitly, the framework could offer more clarity, reducing some of the signaling risk associated with

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[12] In such a framework, quantitative rules could be established for each criterion, making the determination of eligibility non-discretionary and fully transparent since the rules would be published, and the data required for assessing eligibility would be publicly disseminated presumably on a relatively high frequency basis.

[13] A similar pre-qualification proposal was considered, but not adopted, in the early discussions on the CCL. See page 15, *Review of the Supplemental Reserve Facility and Preliminary Consideration of a Contingent Credit Line,* (EBS/98/214).

entry, improving confidence in the value of the insurance available through the CCL, and strength incentives for more policy reform. Further empirical investigation would be necessary before the thresholds could be made operational. It may also be possible to simplify the framework by reducing the number of relevant criteria.

22. **The proposed eligibility criteria would be more explicit than at present in assessing fiscal and external sustainability, data adequacy, and institutional factors.** Factors affecting fiscal solvency, external sustainability, reserve adequacy, the health of the banking system, and the flexibility of the exchange rate regime, would provide for a broad focus on vulnerability sources. The criteria would also take account of members' track record and the future direction of policies. Frequent data disclosure, particularly for the financial sector would also be crucial for the Fund and markets for up-to-date assessments. Institutional strength, such as central bank independence, supervisory autonomy, and the scope for changes in taxation and expenditures systems, as well as the resilience of the fiscal and financial sectors to movements in the exchange rate and interest rates are also key elements. In line with the current policy of voluntary participation in ROSCs and the FSAP, these would not be required for a CCL-eligible member, although the assessment would be considerably strengthened if the member had recently participated.

B. Process for Assessing Eligibility

23. **The staff also considered a number of proposals for changes to the process for assessing eligibility**. Under the present facility, staff has conducted CCL eligibility assessments across a subsection of the membership—those developing countries with capital market openness that borrow in foreign currency, i.e. emerging markets. These assessments have not been shared with the Board or other members. The universe of potentially eligible countries has been kept confidential. More systematic, formal assessments would only be undertaken in the context of an expression of interest by the member.

24. **Systematic public assessments by the Board of CCL eligibility have been proposed by some country officials.** Periodic assessment of members' adherence to the eligibility criteria could be made as part of the surveillance process, and the Board could take a decision on a member's CCL eligibility. Such confirmation of eligibility could signal the Fund's willingness to consider favorably a member's request for a CCL for a predetermined period subject to a limited review or it could grant a CCL without further request by the member for a pre-determined time. Such assessments would be limited to those members that might potentially need support under the CCL, i.e. members with regular access to international capital markets that have not yet attained a top notch sovereign investment grade rating. An assessment of all members with open capital accounts and active participation in capital markets would have very high resource cost for very limited, if any, benefit since such members would be unlikely to use the CCL. In the event that these members would be interested in the facility, the Fund could face a serious liquidity constraint. Public dissemination of a list of eligible members would send a clear signal to members and

to markets.[14] A public list of prequalified members or a unilateral Board provision of access would represent new departures for the Fund.

25. **A regime of periodic public assessments by the Board would raise a number of questions.**

- This approach may be more appealing to potentially eligible members but it would magnify the potentially negative impact on members that did not meet that threshold, and involuntary exit may also have some cost.

- Given the role of discretion in the eligibility process, the staff and the Board could find it difficult to resist pressures to add nearly eligible members or remove those whose policies have deteriorated, which could ultimately undermine the signaling value of the list.

A published eligibility list would give rise to concerns with the Fund becoming a credit rating agency. It could also contribute to increased volatility in capital flows to emerging markets, with an increase in flows to countries on the list and declines to countries taken off the list when a member's policies deteriorate.[15]

26. **Some alternatives to a public eligibility list could also be considered.** The Fund could adopt a systematic, periodic assessment of eligibility but keep the determination confidential. The new eligibility framework would provide some guide to financial markets, but it would not provide certainty. However, confidentiality would be difficult to maintain since the incentive of CCL eligible members would be to make their eligibility public. The Fund could use the Article IV process to provide a more nuanced assessment of policies against the eligibility criteria and indicate where policies meet or fall short of those provisions. This process would give members greater clarity about the terms on which they might be able to access the CCL. Formal eligibility determinations would be left to the initiative of the member. Nevertheless, any regime that involves eligibility criteria cannot avoid the adverse implication for members that fail to meet them.

C. Automaticity and Circumstances Test

27. **An important concern of potential users and financial market participants was the need for greater automaticity to increase the degree of assurance that the CCL**

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[14] The list would be similar in nature to the PRGF-eligible list. Publication of such a list would not require approval of the constituent members, although publication of the individual assessments would require the approval of the member in question according to Article XII, Section 8 of the Articles of Agreement.

[15] It would be particularly critical for the Fund to take members whose policy are deteriorating off the list early, to minimize risk of exacerbating capital outflows once the markets have reassessed the country's prospects, but it may be difficult for the Fund to do so without actually precipitating the outflow.

resources will be available when needed. The 2000 review of the CCL led to modifications that sought to make the availability of the first tranche of resources more automatic by: (i) separating the activation from the post activation review; and, (ii) by narrowing the focus of the activation review to verifying that the need was due to contagion and stemmed from factors beyond the control of the authorities. However, potential users and markets continue to express concern about the uncertainty associated with a Board review at activation and the delay resulting from documents prepared and Board discussion.

28. **A range of options can be considered to streamline the current procedures to lead to more automatic access to CCL resources, to reduce the number of steps involved in accessing CCL resources.**[16] However, an important consideration when viewing these alternatives is the additional risk implied by the gap between Board commitment of resources and potential need as a result of financial market concerns. Notwithstanding stringent eligibility criteria, additional safeguards may be needed to protect Fund resources from rapid changes in countries' circumstances. Possible options to streamline access to CCL resources are:

- *Eliminating the activation review* would remove doubt about the availability of CCL resources in case of crises and substantially reduce delays associated with preparation of Board papers and procedures. Eligible members could request the facility at any time, including when already experiencing balance of payment problems. An eligible member's request would be subject to a limited Board review to confirm that the member is implementing policies consistent with those assessed at the time of eligibility and is ready to take additional measures if needed. If the member is already experiencing balance of payments pressures at the time of a request, the Board review would also confirm that those pressures are not self inflicted. The member would have access to the first tranche without further review for the length of the arrangement, as long as the Board would reconfirm eligibility during the mid-term review.

- *Combining the request and activation review* would streamline the process while preserving an opportunity for a review at the time that the member sought to draw the resources. The Board review would remain limited to confirming that the member is implementing the policies that were assessed at the time of the eligibility and that it is facing pressures that were not self inflicted. Eliminating the potential gap between the request and drawing would address the risk that the member's policies have significantly changed. However, there may still be some delays (if not uncertainty) in accessing the resources at the time of need, since document preparation and Board discussion would need to take place at the time of request and activation. Furthermore, it would make the

[16] Currently, step one involves Board consideration of eligibility and request and steps two involves Board consideration of activation review at the time of need. With the separation of eligibility from the request implied by the eligibility list, this framework would involve three steps: eligibility, request and activation.

CCL closer to the equivalent of an SRF for prequalified members since a member could only request (activate) the facility when facing exceptional balance of payments difficulties.

- *Committing CCL resources to all members on the Board approved CCL eligible list* without any subsequent review at the time of request or activation would provide the strongest assurance of the availability of resources in time of need. But it would provide the least safeguards against potential shifts in countries' policies. A member could purchase the CCL resources without a request or further review subject to reconfirmation of eligibility in the mid-term review. There would be no further check against adverse developments in eligible countries during the six month period up the mid-term review. Strong and effective eligibility criteria, which took account of the member's track record, and willingness to adjust policies, as well robust cushions in key areas, would be the only safeguards to Fund resources.

29. **A further possible modification would be to broaden the circumstances under which the CCL could be requested or used.** Presently a member can only request a CCL if it is not already experiencing pressures on the capital account or the exchange rate, and CCL drawings are allowed only in response to contagion, i.e., "*difficulties [that] are judged to be largely beyond the member's control and to be primarily from adverse developments in international capital markets*". These provisions are designed to strengthen safeguards, but they add complications requiring difficult economic judgments and limit the usefulness of the facility. In a prequalification regime, there would be less need to maintain the blue-sky provision since the eligibility would be separated from the request. Broadening the use of the facility beyond pure contagion to permit a member to use CCL resources for other exceptional pressures on the capital account stemming from factors outside the members' control would also simplify the facility. Members can be expected to face higher interest rates and refinancing risks for a range of reasons outside their control that can have similar effects and require similar responses.

D. Other Design Modifications

30. **Other changes have been proposed to reduce disincentives for using the CCL.** In the staff's view, these disincentives are not fundamental to the lack of interest in the CCL, but they may merit consideration as part of a broader set of changes. Some of the suggested modifications relate to commitment fees, charges, access, and terms and are summarized below:

- **Further reduce or eliminate the commitment fee:** As discussed extensively in the 2000 review of Fund facilities, commitment fees must apply uniformly across all Fund arrangements in the General Resources Account (GRA). In concluding that review the Board had indicated that it would not revisit the issue of commitment fees until 2004. Nonetheless, two options are possible. One, the commitment fee for GRA arrangements on amounts over 100 percent of quota could be reduced to a nominal level, say 1 basis point. On the basis of actual Fund arrangements since 2000, such a change would have reduced the Fund income position by SDR [8] million during this period.[17] Two, no commitment fee would apply if the CCL was structured as outright purchases, as is the case for the Compensatory Financing Facility (CFF) and formerly the Systemic Transformation Facility (STF).

- **Further reduce the surcharge:** Some have argued that the CCL surcharge should be lower than surcharges on resources in the credit tranches reflecting the presumed lower risk with CCL commitments due to stronger policies and more robust economies.

- **Lengthen duration of CCL arrangements from the present 12 months:** An increase to, say, 24 months would assist members in planning and articulating a medium-term strategy and would not imply additional risks to the Fund providing that eligibility was periodically reassessed. However, longer-term commitments of large magnitudes of resources will reduce Fund Forward Commitment Capacity for longer periods. The option to extend CCLs from 12 to 24 months would combine advantages of a longer-term arrangement while retaining scope for flexibility.

- **Increase amount available at activation:** The first tranche under high access SBAs and SRFs in recent capital account crises have averaged about 200 percent of quota. Accordingly, an increase in the CCL purchase to 200 percent at activation could be considered.

- **Change CCL repayment terms so as to be consistent with the modified SRF repayment terms:** In the context of the review of access policy in capital account crises, the Executive Board considered extending SRF repurchase expectations and obligations in late January.[18] In principle, members that avail themselves of the CCL are likely to be in a position to recover relatively rapidly (given the demanding eligibility criteria and strength of such members) and may not require the more extended repayment terms considered for SRF resources. Nevertheless, CCL terms should not be made less attractive to the SRF, and hence the repayment terms could be extended to remain the same as that for the SRF.

31. **A summary of the modification menu is shown in Box 1.**

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[17] This primarily reflects the cancellation of two large arrangements and the non-refunding of commitment fee on the remaining amounts to be drawn, and the completion of one large precautionary arrangement.

[18] *Access Policy in Capital Account Crises—Modification to the Supplemental Reserve Facility (SRF) and Follow-Up Issues Related to Exceptional Access Policy* (SM/03/20).

Box 1. Summary of Possible CCL Design Modifications

1. Eligibility Criteria

(i) Adopt more objective eligibility criteria but retain some scope for discretionary judgment for country specific and non quantitative factors.

2. Process for Assessing Eligibility

(i) Adopt systematic periodic CCL eligibility assessments. Board approval of the CCL-eligible list would signal a presumption to consider favorably a CCL request for a pre-determined period or alternatively, a commitment to make available resources at the time of need.

(ii) The list of CCL-eligible members could be public, or public but optional, or confidential.

(iii) A systematic assessment not directly linked to a Board decision on CCL eligibility; nuanced assessments would be reflected in summing ups and be publicly available through PINs.

3. Automaticity and Circumstances Test

(i) Eliminate the existing "blue-sky" provision at the time of request as it applies to exchange rate pressure or increases in generalized risk aversion by markets.

(ii) Extend circumstances of use beyond contagion to a broader range of capital account pressures.

(iii) Increase automaticity by eliminating the activation review or merging request for the facility with the activation review; or

(iv) Precommitting CCL resource to CCL eligible member without further review.

4. Other

(i) Reduce commitment fees; (ii) lower surcharges to SBA levels; (iii) increase duration of CCL from 12 to 24 months; (iv) increase expected access at activation from one third of total access to 200 percent quota; (v) modify CCL repayment terms to be the same as those for the SRF.

V. BROAD PACKAGES OF MODIFICATIONS

32. **This section discusses three options for going forward.** Two options combine the CCL modifications discussed in the previous section with the key differences being the extent of prequalification and up-front Board commitment. The third option would permit the CCL to expire and the Fund could intensify its efforts in strengthening other policies that could contribute to crisis prevention. These options are summarized in Box 2.

Box 2. Options for Going Forward

- **Both options 1 and 2** focus primarily on reducing entry problems from association with a CCL, while also providing for more flexible terms for activation and greater automaticity of access. Specific changes common to both options would include clearer, less discretionary, eligibility criteria, eliminating the activation review and broadening the circumstances for CCL usage. Commitment fees and charges could be lowered and the length of arrangement lengthened. Some of these changes could be considered independently of others. Both options would be based on a satisfactory economic and financial program with a quantified framework, with a presumption that the member will adjust as needed.

- **Option 1** would also include a Board approved prequalified list of members. Such a list could, for a limited period of time, either signal the Fund's presumption to favorably consider a member's request for assistance under the CCL subject to a limited Board review or a commitment by the Board to provide resources when needed without further review.

- **Option 2** would provide, in the context of the Article IV appraisals, a graduated assessment of members' problems and vulnerabilities against CCL eligibility criteria. This assessment would clearly indicate where members' policies were adequate or need strengthening but without a definitive judgment on CCL eligibility overall.

- **Option 3** would permit the CCL to expire as scheduled in November 2003, reflecting the view that it could not be modified to effectively address its identified problems. The Fund contribution to crisis prevention would be reinforced by enhancing the effectiveness of surveillance, inter alia, with adopting more transparent assessments of financial market vulnerabilities in the context of Article IV consultations, and by modifying precautionary arrangements to make them better suited for crisis prevention.

A. Option One—Public Prequalification

33. **In the context of the adoption of a more objective and transparent framework to determine CCL eligibility, the Board would approve a public list of CCL eligible members.** This option could help address some of the concerns of potentially CCL eligible members that access to a CCL would signal vulnerability. In addition, by increasing automaticity, it would strengthen assurances of access to eligible members of the first large purchase. However, this option would introduce incentives for eligible members to delay a CCL request until under pressure, increase risk of adverse market reaction to members excluded from the list, and perhaps, most importantly, it would move the Fund closer to providing public ratings and raise associated complex institutional issues.

34. **The details of option one are:**

- **New criteria would be established to make eligibility decisions more objective and less discretionary.** The discretionary elements of the eligibility assessment would center upon the strength of the institutional framework, in particular as regards the formulation of fiscal policy, the independence of the monetary authorities and the effectiveness of financial sector supervision. The proposed criteria (detailed in Annex III) would be made public in order to increase transparency for both members and market participants.

- The Executive Board would periodically determine CCL eligibility in the context of surveillance and staff visits based on the authorities' public economic program on a semi-annual schedule.

- **The CCL eligibility list could be expanded to include eligible mature as well as emerging market economies, however this could have important implications for Fund resources and liquidity.** Semi-annual assessment exercises of all mature economies would be resource intensive with limited benefit since such members would be unlikely to use the facility. If such members would indicate interest in potentially using the facility, the Fund may not have sufficient liquidity to meet potential demand.

- **The Board approval of a CCL eligible list would signal the presumption that the Board would consider favorably a member's request for financial assistance under the CCL subject to a limited Executive Board review.** The member would still need to request a CCL arrangement at which time the Board would need to confirm that the member is implementing policies consistent with the economic and financial program assessed at the time of the Article IV or mid-term review and that the member stands ready to adjust policies as need be. Members on the CCL eligibility list could request the facility at any time including when already experiencing balance of payment pressures in the capital account.

- **The activation tranche could be purchased at any time after approval of the CCL without further Board review subject to reconfirmation of eligibility during a six**

monthly review. The request and activation could also be merged, and a limited Board review would confirm adherence to the proposed policy framework and that the balance of payments pressures was not self inflicted.

- **Members could use CCL resources for balance of payments pressures in a broader range of circumstances than envisaged in the present CCL.** Members could activate the facility in response to capital account pressures in general, including from changes in global risk aversion, and exogenous shocks to the current account.

- **To make a purchase beyond the activation tranche, a Board review would continue to be necessary.** The post activation review would determine the phasing and conditions for remaining purchases.

- **Commitments under the CCL would normally not exceed 500 percent of quota with the amount available for the initial tranche normally not exceeding 200 percent of quota (compared to 167 percent of quota presently).**

- **The surcharges on the CCL would be lowered and would not exceed surcharges applied to resources in the credit tranches.** In comparison to current CCL surcharges, this would reduce annual interest charges by 20-90 basis points depending on access and whether repaid according to expectation or obligation schedule. Commitment fees on access above 100 percent of quota could also be further reduced to nominal levels or would not apply if the access to CCL resources was made available as outright purchases. The length of the CCL could be extended to 24 months. Maturity would remain the same as for SRF resources (which may be revised soon).

B. Option Two—Graduated Assessment

35. **Option two includes many of the proposed features of option one except for a Board approved public eligibility list.** In particular, more objective eligibility criteria would provide for clearer signals for CCL eligibility; members could use the CCL resources for balance of payments pressure in a broader range of circumstances than envisaged presently; the initial tranche could be purchased at any time after approval of the CCL request without further Board review; initial access could be increased; surcharge and commitment fee would also be reduced; and the length of the CCL arrangement could be extended.

36. **This option is distinguished from the previous one in that no pre-qualification by the Executive Board takes place.** Rather, Article IV consultations for likely candidates would include an assessment against the published eligibility criteria. Such an assessment would provide clearer signals than now, but would not provide a binary decision associated with a Board determined eligible list. This option reduces the potential adverse effects of a member not considered CCL eligible or of losing eligibility. Eligibility would be formally established by the Board only at the time of a CCL request (as at present). The Executive Board assessment would emphasize the policy areas that need to be strengthened to meet the

eligibility criteria and provide the member greater confidence as to how the Board would respond to a request for a CCL. A summary of the assessment would normally be reflected in the Public Information Notice (PIN).

37. **Another difference is the extent of assurance of access to CCL to likely eligible members.** In the absence of preapproved Board CCL eligible lists, members would only have assurances of CCL resources if they request the facility. If a member were to request the CCL when already facing balance of payments pressures in the capital account, the Board would need to weigh the balance of evidence to determine if policies were appropriate or partly responsible for the member's circumstances. Consideration of which member may or may not avail themselves of the CCL as opposed to the SRF could become less transparent.

38. **As in option one, this option could help enhance the effectiveness of surveillance and promote stronger incentives to members to strengthen policies towards the eligibility standards.** However, option two would suffer from some of the disadvantages of a published list if it is to provide a more candid assessment of members' policies and circumstances. Both assessment options would raise concerns about the Fund taking on a rating agency role. A key question is whether option two would lead to requests from a significant number of eligible countries. The combination of additional changes to remove the activation review, modestly increase expected access at activation and reduce charges might be sufficient in changing perceptions, but there is also a risk that these changes may not lead to increased interest in the facility.

C. Option Three—CCL Expiry

39. **The CCL expires in November 2003 unless extended by the Board.** The Board could allow the CCL to expire and focus the Fund's crisis prevention efforts on sharpened surveillance and improvements to other existing facilities. The proposed revised eligibility criteria could be adapted for use in Article IV consultations to provide an enhanced framework for more objective and transparent assessments of vulnerabilities, strengthening incentives for members to buttress policies.

40. **Focused assessments in the context of surveillance of members' vulnerabilities could provide incentives, especially for emerging market economies, to strengthen policies and could be the basis for a more timely and effective Board response in time of crisis.** Article IV consultation assessments could elaborate on policy action needed to reduce vulnerability to rapid shifts in capital flows, encouraging members to adopt pre-emptive measures where needed. This would facilitate a rapid response by the Fund and reduce some of the uncertainty members face about the scope and content of the conditions that might be required for an arrangement, if an arrangement would prove desirable following the Article IV. By using the Article IV consultation to identify the policies that would be necessary in the event that the authorities were to request an arrangement, members would have greater clarity as to the policy requirements of a Fund supported program and improve the incentives for sound policies and early engagement with the Fund. Of course, the

conditions for Fund supported programs could not be specified in detail independent of the circumstances that gave rise to a request for a Fund arrangement.

41. **There is also scope to explore ways in which the Fund's existing instruments could be adapted to strengthen the Fund's capacity to respond quickly and flexibly to the needs of members with strong policies.** In this context, there is merit to examining the scope for broader use of arrangements that are treated as precautionary to make them more effective in crisis prevention and more attractive to potentially vulnerable members. Precautionary arrangements are another means of providing some of the benefits offered by the CCL. Similar to the CCL, these arrangements can provide access to Fund resources in the absence of an immediate balance of payments need. However, such access is provided within a framework of conditionality. Such arrangements are more flexible than a CCL since they can be extended to a broader range of countries as there are no eligibility requirements or pre-qualification, and they can be used for the full range of potential balance of payments shocks.

42. **The Fund could consider more systematic use of high access arrangements that would be treated as precautionary by members.** Members that could potentially benefit from such arrangements would be those that routinely access international capital markets and face potentially large balance of payments pressures as a result of adverse financial capital market conditions. High access could be provided under the Supplemental Reserve Facility (SRF) and in the context of the Fund's new framework for exceptional access.[19] By providing significant amounts of access in the absence of an immediate balance of payments need, precautionary arrangements can help encourage members to approach the Fund for support early before a full blown crisis. In the event of a shock, evidence of Fund support could also reduce financial market pressures and potential magnitude of balance of payments need. However, the use of the SRF for precautionary purposes would require making explicit that the SRF would be available in the event of a potential need, not just an actual need, as currently.

43. **However, the current architecture of Fund arrangements is not well suited to precautionary arrangements for high access cases**. Some features, such as the interruption of drawing rights between test dates for performance criteria and the availability of data for these performance criteria and the completion of Executive Board reviews, create perverse incentives encouraging pre-emptive purchases and reducing assurances to the member of the availability of Fund resources.[20] At the same time, high access and cumulative purchases

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[19] Use of the SRF would limit drawings under such high access arrangements to those that are consistent with the SRF decision.

[20] For example, a member who has observed program conditions may purchase accumulated financing up to the next scheduled test date after which it temporarily loses access until the data for that test date become available and the associated review is completed. In most cases the period for which accumulated access is not available is about four to six weeks.

increase risk to Fund resources, since a member could purchase accumulated amounts as the program is going off-track.

44. **Modifications could be considered to strike a better balance between providing members with sufficient crisis prevention "insurance", while maintaining adequate safeguards to Fund resources.** These could include: (i) more front-loaded phasing, perhaps with one large "floating" tranche made available in place of accumulating drawing rights: (ii) phasing of successive purchases determined when and if this initial purchase is drawn; (iii) extending the applicability of drawing rights beyond test dates for performance criteria to pre-established dates at which the relevant data is expected to become available**,** and (iv) lessening the prospects of purchases when the program is going off track by introducing an enhanced monitoring framework including selected high-frequency performance criteria. These proposals may be worth pursuing independently of the outcome of the CCL review.

VI. Conclusions and Issues for Discussion

45. **The present design of the CCL is not viable**. Two broad options for modification were presented, which have many common elements. Option one (public prequalification) could address the entry problems, strengthen incentives to meet CCL eligibility criteria, and streamline requests and activation. However, it also raises difficult issues relating to the Fund's role in making explicit and public determination of eligibility, including the inevitable costs for members who were not prequalified, or who become ineligible. These options also raise difficult tradeoffs in providing greater automaticity to Fund resources to eligible members and safeguarding Fund resources. Option two (graduated assessment) could also strengthen the surveillance framework but without the potentially high cost of a public list. However, the more nuanced signaling of eligibility may not be as strong an incentive as a public list for likely eligible candidates, and, the modifications may not sufficiently distinguish the facility operationally from its current form to lead an increase in the likelihood of its use.

46. **In the absence of a clearly workable strategy to modify the CCL to make it more attractive to potentially eligible members, the staff and management are inclined to believe that the facility should be allowed to expire in November 2003.** At the same time, there is scope to strengthen Fund policies aimed at crisis prevention, including developing an enhanced surveillance framework utilizing more objective assessment criteria for evaluating vulnerability and modifying high access precautionary arrangements. These efforts could ensure that the Fund has adequate instruments to respond quickly to help members with strong policies that are facing capital account pressures. The forthcoming review of surveillance will provide a further opportunity to consider ways to enhance its contribution towards crisis prevention. If the Board agrees, the staff also proposes to prepare a paper on modifying high access precautionary arrangements for Board discussion, which could provide vulnerable emerging market economies some insurance against capital account crisis.

47. **This paper has raised several issues on which guidance from the Board is sought.** The broad questions for consideration are:

- How do Directors weigh the relevance of the various impediments to requesting a CCL? Do Directors agree that the CCL is not viable in its present form?
- Do Directors consider the framework of more objective eligibility criteria coupled with discretion to be more appropriate than the current framework? Could such a framework be adopted for selected Article IV consultations? Would a nuanced assessment be effective in providing incentives for strong performers?
- Do Directors consider it appropriate for the Fund to publish a list of CCL eligible countries? Or would the associated cost be too high?
- Do Directors feel comfortable that the more objective eligibility criteria would balance the additional risk by providing more automatic access to Fund resources for qualified members? Would Directors favor a process where the request and activation review are combined?
- In the absence of a prequalification list, does option two provide a sufficient basis to proceed with a modification of the CCL?
- In the context of moving forward with modification of the CCL, which other potential modifications do Directors envisage as important to make the CCL more attractive to potential users?
- Do Directors consider either option one or option two as a viable way to proceed with the modification of the CCL or do they think that the facility should be allowed to expire as scheduled?
- Does the Board feel that a paper on modifying high access precautionary arrangements would be useful, whether or not the CCL is permitted to expire?

OPERATIONAL FEATURES OF THE CCL (AS AMENDED NOVEMBER 2000)

CCL Eligibility Criteria

Financing under the Contingent Credit Lines[21] will be committed to a member:

(i) That, at the time of the commitment, is implementing policies that are considered unlikely to give rise to a need to use Fund resources, and is not already facing balance of payments difficulties of the type that would justify the activation of the CCL;

(ii) Whose policies have received a positive assessment from the Fund at its last Article IV consultation and whose policies have continued to be assessed favorably by the Fund thereafter based on economic indicators reflecting domestic stability and external sustainability, and taking into account the extent of the member's adherence to relevant internationally-accepted standards; in particular, the member would have subscribed to the Special Data Dissemination Standard and be judged to be making satisfactory progress towards meeting its requirements;

(iii) That is maintaining constructive relations with its private creditors with a view to facilitating appropriate involvement of the private sector, and has made satisfactory progress in limiting external vulnerability through the management of its external debt and international reserves; and

(iv) That has submitted a satisfactory economic and financial program, including a quantified framework, which the member stands ready to adjust as needed.

Monitoring and mid-term review

To ensure that the conditions needed to activate a CCL can be rapidly assessed, the staff would maintain close monitoring of economic and especially financial market development, including through regular contact with the authorities. Comprehensive data would be provided to staff at appropriate intervals.

A mid-term review would be scheduled at the time of the CCL request. It would provide an opportunity for the Board to reconfirm that a member's economic program remains appropriate. After the date, the mid-term review will need to be completed before a purchase associated with the activation review can be released. It would permit the Board to "*satisfy itself that the member was successfully implementing the economic program earlier presented to the Board and had adjusted that program appropriately in response to any changes in circumstances*." It is possible to complete the mid-term review on a lapse-of-time basis.

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[21] From Decision No. 12340-(00/117) SRF/CCL, November 28, 2000, page 236-46 of *Selected Decisions* 2000.

Activation review

A member for whom a CCL has been approved, may request access to these resources at any time subject to an **activation review** by the Board. The activation review, would be expeditious, and if completed, would make available the associated purchase, which would normally be one-third of access under the CCL.[22] The activation review would be completed if the Board were satisfied that:

(i) The member is experiencing exceptional balance of payment difficulties due to a large short-term financing need resulting from a sudden and disruptive loss of market confidence reflected in pressure on the capital account and the member's reserves; and

(ii) These difficulties are judged to be largely beyond the member's control and to be primarily from adverse developments in international capital markets consequent upon developments in one or several other countries.

Activation would be completed on the presumption that the member remains committed to deal with any significant economic impact from contagion and the member is given the strong benefit of the doubt in this respect.

Post-activation

A post activation review would normally follow the activation to determine the conditionality and phasing for the amount not made available at the activation review, normally two thirds of total access. Such phasing and conditionality would normally resemble upper credit tranche arrangements, although conditionality would not generally be expected to involve changes in structural policies, although it could involve continuation of those structural measures discussed in the request for the CCL.

Terms

CCL resources are subject to a commitment fee of 25 basis points for the first 100 percent of quota and 10 basis points for all amounts above that. The rate of charge is lower than under the SRF, incorporating a surcharge over the GRA rate of charge that rises from 150 to 350

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[22] On Board approval of a CCL, the first credit tranche will be made available to the member, releasing between 5 and 25 percent of quota depending on whether the member has outstanding Fund Credit. A purchase would not be expected because the arrangement is precautionary.

basis points. Repayment terms are those for SRF resources prior to the current consideration of an extension (these were: repurchase expectations at 1–1½ years from the date of purchase, and obligation of 2–2½ years from the date of purchase).

PROPOSALS TO IMPROVE THE EFFECTIVENESS OF THE CCL AND OUTREACH CONSULTATIONS

In reviewing the CCL, staff drew upon published proposals to make the CCL effective and conducted outreach sessions with selected officials and private sector representatives to receive input on a discussion paper which was a precursor to this paper.

1. Published proposals

In the context of a range of proposals to reform policies relating to the international financial system, including crisis prevention and resolution, **the UK authorities** (Chancellor Brown) proposed to enhance the CCL and to encourage its take-up through:[23]

- Article IV surveillance to discuss potential eligibility for the CCL for all member countries with a presumption that such Article IV assessments be published;
- The Fund to take a proactive role in identifying countries for the CCL to meet a target for requests;
- Outreach and collaborative work with the private sector to strengthen their understanding of the quality of policies that the CCL would support;
- Targets for number of CCL requests; and
- Abolish the commitment fee and reduce the rate of charge.

In drawing lessons and policy recommendations from the capital account crises of the 1990s, **Mr. Ortiz, Governor of the Central Bank of Mexico** proposed several modifications to the CCL in order that it might become a more effective mechanism to provide additional international reserves to a country with adequate policies that was nonetheless facing liquidity problems. In particular Ortiz suggests:[24]

- Clearer guidelines to inform markets about criteria determining eligibility and other efforts to reduce the stigma of the facility;
- Broader circumstances for use of the CCL to include temporary terms of trade shocks or adverse developments in industrial country financial markets;
- Reduce the commitment fee, perhaps to zero;

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[23] Drawn from HM Treasury, *Surveillance and the New International Architecture*, November 2001, and speech to British American Business Inc., April 2002 available on the internet at http://hm-treasury.gov.uk .

[24] Ortiz, Guillermo, *Recent Emerging Market Crises-What have we learned?* Per Jacobsson Lecture, July 2002.

- Extend maturity of the CCL beyond one year.

As part of an action plan on crisis prevention and resolution, **The Institute for International Finance** (IIF) discussed inclusion of CCL eligibility assessment in Article IV consultation reviews, and recommended in particular:[25]

- Public Board prequalification of countries eligible for a CCL;
- Prequalified countries to have an assurance of automatic access to Fund resources when needed.

In an analysis of policies to strengthen Asian monetary and financial cooperation the **Institute for International Economics** (IIE) suggests that Asian countries which prequalified for a CCL might amend the provisions for drawing on bilateral official swap arrangements, including under the Chiang Mai initiative, hitherto limited to countries which had an IMF arrangement in place or nearly in place.[26]

2. Outreach meetings

Staff met with officials from Chile, Estonia, Germany, Mexico, Netherlands, Slovenia, South Africa, UK, and USA for a roundtable discussion in Washington DC on November 19, 2002. The discussion centered around presentations by selected officials and a staff discussion paper outlining the problems with the existing facility and a range of possible modifications to address such problems. There was broad consensus on the problems but not a high degree of confidence that a viable facility could be designed which addressed the key problems. There was support for eligibility assessment in the context of Article IV discussions but concern that public determination of eligibility would have costs and risks. Many participants felt that these costs and risks outweighed potential benefits, in particular the inevitable costs associated with exclusion or exit from an eligible list. There was support for more objective eligibility criteria. Some participants also favored widening the range of shocks that the CCL could be used for. Many participants argued that automaticity was a critical feature of a viable facility once eligibility was established.

Staff met representatives of investment banks, underwriting companies, and rating agencies from Europe and the United States in New York on December 11, 2002 for a roundtable discussion following the format of the outreach with selected officials. Private sector participants noted that markets are better able to differentiate between emerging economies

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[25] *Action Plan of the IIF Special Committee on Crisis Prevention and Resolution in Emerging Markets*, Institute for International Finance, July 2002, available at http://www.iif.com.

[26] Henning, C. Randall, *East Asian Financial Cooperation*, Institute for International Economics, September 2002.

reducing the likelihood of contagion and hence the need for the CCL. However, participants agreed that contagion could not be ruled out, suggesting a role for the CCL for good performers, particularly if the CCL would protect members from a wider range of shocks, including developments in mature markets. Participants recognized that there were entry problems associated with a CCL, in part because of asymmetric information and perhaps from the authorities' domestic political concerns. Clearer and more objective eligibility criteria together with a constrained scope for discretion were widely supported by the participants, as this would enable markets to come to a judgment on eligibility and reduce surprises. Market uncertainty could be further reduced with a published list of eligible countries, which would also strengthen the incentive role of the CCL, although participants emphasized the political pressures on the Fund that might result—yielding to such pressures would lessen the signaling value of a public list. Participants stressed the importance of automaticity and larger access if the CCL was to have the desired impact on markets, while recognizing that it would be difficult for the Fund to commit large amounts without appropriate conditionality.

Possible CCL Eligibility Criteria for Constrained Discretion

Eligibility for the CCL would be based on criteria defining fiscal, monetary and external policies, an assessment of limited external and financial vulnerabilities, and considerations related to data disclosure and the strength of policymaking institutions. CCL eligibility would require meeting substantive standards in each area (fiscal, monetary, external, data, and institutions), informed by an assessment against indicative thresholds. Within each area, relevant factors that facilitate a comprehensive view of a member's vulnerability would also be taken into account. An initial list of criteria and data for which indicative thresholds would need to be set is proposed below. Significant additional empirical work would be needed to make such criteria and thresholds operationally robust. A CCL-eligible country would need to have a quantitative framework in place for the duration of the CCL. The eligibility assessment would include a forward looking review of policy against the criteria detailed below.

Fiscal policy and government debt

1. **The overall fiscal policy stance of the government should be consistent with a sustainable balance of payments position, a prudent level of domestic demand, low inflation, and provide for an adequate cushion to absorb shocks, either by a temporary increase in the deficit, or adjustment in spending or revenues.** In coming to a judgment of an appropriate fiscal stance, consideration would be given to fiscal deficit of the general government at or below a threshold of [ ] percent of GDP for the forthcoming, current and previous three consecutive years, taking into account the direction and rate of change. The five year period would proxy a business cycle. The cyclically adjusted fiscal deficit would be a better measure of appropriateness of the fiscal stance, however, estimation of output gaps involves some subjectivity rendering this approach impractical for an objective threshold.

2. **Projections of public sector debt dynamics should remain stable and sustainable and reasonably robust to shocks to GDP growth**, **interest rates and the real exchange rate**. Sustainability would be assessed by the feasibility of adjustment to attain a primary surplus which stabilizes the debt stock at, or below, a public debt/GDP threshold of [ ] percent. The assessment of performance against the threshold would be complemented by other relevant indicators, including:

- Debt/exports;
- Debt service/fiscal revenues (last and prospective twelve months);
- Projected short-term debt by remaining maturity/GDP, trends over the past five years, and other measures of near-term financing needs;
- Projected and current foreign currency denominated public debt/total public debt and/or current account receipts of [ ];

- Sovereign external debt spreads and credit ratings;

- An assessment of actions taken by the member to lessen vulnerabilities through management of liquidity risk, and actions such as inclusion of collective action clauses (CACs).

Monetary and financial sector

1. **Monetary policy should be consistent with continuing low and stable inflation**. In coming to this judgment, consideration would be given to performance relative to a benchmark for consumer price inflation of below [ ] percent for the next 12-months and the past three consecutive 12-month periods.

2. **The banking and financial system should have prudent and well-understood exposures to risk, based on international best practice standards**. This assessment would be informed by:

- The strength of bank supervision and adherence to Basle Core Principles, including capital adequacy ratios, liquidity ratios, asset quality indicators (NPL ratios), and adequate measuring, monitoring and control of market risk.[27]

- Stress tests showing that vulnerability to realistically large shocks to interest, exchange, and rollover rates—including the risk to credit quality when borrowers are vulnerable to these market risks—are within acceptable limits, including based on analyses undertaken in the context of FSAPs.

External sector

1. **The current account position should be sustainable, taking into consideration domestic demand factors, the composition of financing (debt creating vs. non debt creating), and maturity and liquidity of non-resident claims**. Such a judgment would be informed by:

- An average current account deficit projected for the current and forthcoming year and over the last three years;

- Financing flows;

- External debt stock taking into account maturity profile and servicing cost.

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[27] This assessment would not require an FSAP but would be much strengthened for members that have recently undertaken an FSAP.

2. **The foreign exchange reserve cushion should be adequate to deal with reasonable shocks to demand for foreign exchange**. In coming to this judgment, performance would be assessed against a threshold ratio of [ ] for international reserves/short-term debt (sovereign and banking system) by remaining maturity, in past, current and prospective years. This assessment should also take into account off-balance-sheet derivative transactions of the monetary authorities.

3. **The exchange rate regime should be resilient to external shocks, with a presumption that flexible regimes are more likely to meet this test**. This assessment would be informed by developments in the real effective exchange rate over the past year, in comparison to longer-term averages. Special considerations may be needed on how to treat currency boards and pegged arrangements such as the countries that are transitioning to the EMU.

Data availability

1. **High frequency data reporting would be expected for key indicators.** These include: NIR, monetary aggregates, aggregate bank deposits in domestic and foreign currency, macro-prudential indicators, banks' foreign exchange position including off-balance sheet items, selected fiscal data, financing, interest rates, roll-over rates and market spreads. Eligible members would need to meet higher data reporting and quality standards than required for the SDDS. Members would be expected to make such data publicly available with minimal time lags. ROSC data modules using the Data Quality Assessment Framework would facilitate assessments.

Institutional criteria

1. **Key institutions would need to be strong and transparent, to support effective policymaking and implementation**. The key elements of this assessment are:

- A rolling medium-term fiscal framework facilitating a consolidated fiscal sustainable stance, including pre-specified annual targets, binding legal constraints on spending, financing, and balances, and effective control at all levels of government;

- Demonstrable de jure and de facto independence of monetary authorities within the general constraint of accountability. Eligible members would have transparent and robust monetary and financial policies;

- Effective and independent framework for financial sector supervision. Eligible members would have demonstrated operational independence of financial supervisors and close contacts with their relevant counterparts in other countries. The assessment could draw upon third party assessments of institutional factors, such as corruption indices.

2. **ROSCs and the FSAP would form an important basis for institutional assessments**. Judgment on institutional adequacy would take account of:

- Efforts to address material concerns relating to the strength of the institutional framework in the staff appraisals of ROSCs and FSAPs;

- Willingness to undertake report on standards or codes relevant to key institutional appraisal (i.e., fiscal transparency, monetary and financial transparency, bank supervision, corporate governance or insolvency and creditor rights) or to participate in a FSAP.