INTERNATIONAL MONETARY FUND

The Fund's Facilities and Financing Framework for Low-Income Countries

Prepared by the Strategy, Policy, and Review and the Finance Departments
(In collaboration with other departments)

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Abbreviations and Acronyms

CCL	Contingent Credit Line
CFF	Compensatory Financing Facility
DSA	Debt Sustainability Analysis
ESAF	Enhanced Structural Adjustment Facility
EFF	Extended Fund Facility
ENDA	Emergency Assistance for Natural Disasters
EPCA	Emergency Post-Conflict Assistance
ESF	Exogenous Shocks Facility
FDI	Foreign Direct Investment
GFR	Gross Financing Requirement
GMR	Global Monitoring Report
GRA	General Resources Account
HAC	High-Access Component
HIPC	Heavily Indebted Poor Country
IDA	International Development Association
LIC	Low-Income Country
MDG	Millennium Development Goal
MDRI	Multilateral Debt Relief Initiative
PRGF	Poverty Reduction and Growth Facility
PRSP	Poverty Reduction Strategy Paper
PSI	Policy Support Instrument
RAC	Rapid-Access Component
SAF	Structural Adjustment Facility
SBA	Stand-By Arrangement
SMP	Staff-Monitored Program
TA	Technical Assistance
TIM	Trade Integration Mechanism
UCT	Upper-Credit Tranche

EXECUTIVE SUMMARY

This paper assesses the adequacy of the Fund's facilities and financing framework for low-income countries (LICs) and proposes reform options. It is part of a broader review of all Fund financial instruments and is timely given the pressure the current global financial crisis is putting on LICs. It builds on previous efforts to adapt the Fund's toolkit to the evolving needs of its LIC members, including creation of the Policy Support Instrument (PSI) and the recent modification of the Exogenous Shocks Facility (ESF). This paper provides the basis for the first stage of the LIC-specific review, with a focus on: (i) gaps and overlaps in the facility architecture for LICs, (ii) design issues such as access, financing terms, and conditionality, and (iii) the concessional resource envelope and funding structure. Based on feedback from Executive Directors and further external consultation, more detailed reform proposals will be prepared in the second stage of the review.

LICs have made extensive use of the Fund's concessional facilities, and most have achieved marked improvements in economic performance over the past two decades. Of the 78 countries eligible for the Poverty Reduction and Growth Facility (PRGF), four-fifths have received Fund financing, and three-quarters have been supported under the PRGF or its predecessor. Countries that have made extensive use of Fund facilities showed significant increases in long-term growth, exports, and foreign direct investment (FDI), while also achieving a noticeable reduction in inflation, external debt (supported by debt relief), and current account and fiscal deficits, closing the performance gap with other LICs.

To preserve these gains, the Fund's toolkit for LICs will need to become more flexible in light of increasingly diverse country needs and heightened exposure to global volatility, including during the current global crisis. Many LICs are still undergoing longer-term adjustment efforts to address entrenched macroeconomic and structural imbalances, and can benefit from PRGF-type financing to smooth the adjustment process. In addition, more than one-third are in fragile situations, with some requiring emergency financing. At the same time, an increasing number of LICs have achieved broadly sustainable macroeconomic positions, and some have moved to low-access or non-financial IMF-supported programs as policy support, commitment, and signaling devices. However, many LICs have also become more exposed to global volatility, including due to higher private capital inflows and trade volumes, and about one-third are particularly vulnerable to the ongoing global crisis (as discussed in the staff paper on the impact of the crisis on LICs). These factors suggest a relative shift in demand toward more episodic, short-term Fund financing (at higher access levels) and precautionary arrangements.

To meet the changing needs of LICs, it will be important to close three notable gaps in the Fund's concessional toolkit: (i) flexible short-term financing; (ii) a precautionary instrument; and (iii) flexible emergency financing. First, neither the ESF nor the PRGF effectively addresses short-term financing needs primarily caused by domestic factors such as policy slippages, banking troubles, or confidence problems. This gap may become increasingly important as LICs become more exposed to volatility from international integration and financial market liberalization. Second, the lack of a concessional precautionary instrument constrains the Fund’s capacity to play a stabilizing role as LICs gain market access and become more exposed to global turmoil. Third, countries with limited policy implementation capacity can be supported in the aftermath of natural disasters, conflicts, or exogenous shocks, but not in other emergency situations where financing is critical to prevent a precipitous deterioration in economic and social conditions. In addition to gaps, there are also overlaps, particularly with respect to instruments for addressing shocks and emergencies, and ambiguities with respect to the choice of the appropriate instrument, suggesting potential benefits from streamlining.

To strengthen the Fund's LIC facilities architecture, three broad reform options could be considered. Each would cover the main types of financing needs (precautionary, emergency, short-term, and medium-term) under different economic circumstances (protracted, short-term, or no adjustment needs) and policy capacity. The PSI could be maintained under each option.

- **Option 1:** Make the PRGF more flexible by including a short-term window for shocks and policy slippages (eliminating the need for the High-Access ESF); allow precautionary use of this window; and broaden Emergency Post-Conflict Assistance (EPCA) to cover a wider range of needs. This option would streamline facilities and keep the PRGF as the main facility for programs with significant policy content.

- **Option 2:** Keep the PRGF unchanged for medium- and longer-term adjustment needs; create a concessional short-term financing facility similar to the Stand-By Arrangement (SBA) that could also be used on a precautionary basis (effectively replacing the High-Access ESF); and cover natural disaster, post-conflict, and other emergency needs through a unified concessional emergency assistance facility. This option would tailor facilities to the main types of LIC adjustment needs.

- **Option 3:** Replace existing facilities with a single concessional instrument with flexible length (up to three years) for all balance of payments needs; as a transitional measure, the PRGF would be retained for pre-completion point Heavily Indebted Poor Countries (HIPCs). This option would go furthest on streamlining and deviate most from the status quo.

Access limits should be raised to ensure that the Fund has the ability to assist effectively those LICs most exposed to global volatility, including in the current crisis. Concessional access limits and norms have gradually declined relative to GDP and trade, while LICs have become more exposed to global volatility. Access limits have already become binding in several cases, and the current global financial crisis is likely to result in large-scale balance of payments needs for a number of LICs, arguing for an increase in access limits and norms.

Other program design features should also be adapted to meet LIC needs in a changing world. Specifically:

- PRGF-ESF **financing terms**, which remain broadly appropriate, should be extended to all types of Fund assistance for LICs. In particular, they should apply to emergency assistance for LICs, which is currently less concessional, given shorter maturities, even though it is often used by highly vulnerable countries.

- Rules for **blending** concessional and General Resources Account (GRA) financing should be clarified and strengthened, and **eligibility for concessional assistance** should be assessed regularly. This could help ensure that concessional resources are targeted to members most in need of concessional terms.

- In **assessing financing needs**, the PRGF standard of a "protracted balance of payments problem" remains relevant for countries facing medium- or longer-term adjustment needs, but short-term facilities should be based on present balance of payments needs.

- Following recent streamlining efforts, **conditionality** should be modified to give countries greater flexibility while supporting macro-critical policies. Conditionality should be tailored to country circumstances and facilities. Recommendations from the review of conditionality in the GRA context could usefully be adapted to LICs to allow more flexibility, in particular with respect to the timing of structural reforms.

Additional resources would need to be secured to meet the demand for the Fund's concessional financing, which is expected to double over the short and medium term. A spike in demand due to commodity price shocks and the impact of the global economic downturn is already apparent. The evolving needs of LICs facing greater volatility as well as the potential creation of new instruments to close gaps could boost demand further. Demand is projected to average about SDR 1.5 billion a year (double the 2008 level) over the medium term, exceeding currently available resources and the estimated "self-sustained" subsidization capacity of the PRGF-ESF Reserve Account. Meeting the projected financing needs through 2015 could require additional subsidy resources of about SDR 0.7 billion and new loan resources of SDR 9 billion.

Concessional resources could be used more flexibly through a more structured approach to fund-raising that allows donors to make their contributions available to support the broad range of lending facilities. Periodic rather than *ad hoc* fundraising would reduce uncertainty and ensure that the Fund could meet the financing needs of LICs in a timely manner. A more flexible financing structure would allow resources to be used for all types of concessional assistance.

I. Introduction

1. **The review of the Fund's facilities[1] and financing framework for low-income countries (LICs) is part of a broader review of the Fund's facilities.[2]** This paper assesses the adequacy of the Fund's toolkit for LICs, with a view to ensuring that it keeps pace with a changing world, particularly as global economic conditions deteriorate and put pressure on countries. It builds on substantial work undertaken in recent years to clarify the Fund's role in LICs and to adapt its toolkit, including creation of the Policy Support Instrument (PSI) for non-financial engagement and recent steps to modify the Exogenous Shocks Facility (ESF) to make it more useful to LICs in light of external shocks.[3] Executive Board discussions of the Fund's role have emphasized the importance of helping LICs achieve the macroeconomic and financial stability needed to raise growth and reduce poverty through policy advice, targeted support for capacity building, and, where appropriate, financial assistance.

2. **In order to assess the adequacy of the Fund's existing instruments for LICs, the review seeks to answer the following key questions:**

- What are the needs of LICs in relation to Fund financing and how have they changed?
- How have existing instruments met LIC needs, and are there gaps or overlaps?
- Could changes to access rules, financing terms, or conditionality help the Fund better support LICs?
- What is the available concessional resource envelope and how will the changing external environment affect possible financing needs through the medium term?
- What scope is there to make the concessional financing framework more flexible?

3. **This paper represents the first stage of a consultative process to review LIC facilities and will be followed by more specific proposals based on the feedback of Executive Directors.** The paper aims to take stock of the existing toolkit, provide an

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[1] The terms "instrument" and "facility" are used interchangeably to refer to all Board-endorsed facilities, instruments, and policies to support LIC programs, namely the PRGF, ESF, and PSI, as well as those open to all members (EPCA, ENDA, SBA, EFF, CFF, and TIM). The review does not cover surveillance, technical assistance, SMPs, or financing provided through debt relief (i.e., HIPC/MDRI).

[2] *Review of the Fund's Financing Role in Member Countries*.

[3] *The Role of the Fund in Low-Income Countries*; *Statement by the Managing Director in the Role of the Fund in Low-Income Countries*; *Proposed Reforms to the Exogenous Shocks Facility*; *The Fund*'s *Engagement in Fragile States and Post-Conflict Countries—A Review of Experience—Issues and Options*;and *Implementation of the Policy Support Instrument*.

analytical framework, identify challenges, and sketch broad reform options. It draws on past policy work, an empirical assessment of financing and economic trends, recent country experiences, a survey of mission chiefs, and consultation with outside experts. Based on the views of Executive Directors and additional external consultations, including with country authorities, staff will prepare more detailed proposals in the second stage of the review. The broader review of Fund facilities will feed into these proposals.

4. **The paper is organized as follows.** Section II reviews the existing toolkit, the usage of facilities, and LICs' economic performance. Section III examines the analytical underpinnings of IMF lending to LICs, and their changing needs. Section IV discusses gaps and overlaps in the architecture, and proposes reform options. Section V discusses facility design (access policies, financing terms, balance of payments needs criteria, and conditionality). Section VI examines the availability of concessional resources and potential LIC financing needs. Section VII discusses the concessional financing framework, and provides possible reform options. Section VIII seeks Executive Directors' views.

II. Experience to Date

A. The Fund's Evolving Toolkit

5. **For over three decades, the Fund has complemented General Resources Account (GRA) financing available to all members with specific non-GRA financing for LICs via administered accounts under Article V, Section 2(b).** Table 1 shows resources and facilities currently available to LICs. The evolution of LIC-specific facilities reflects a long-standing consensus on the need for concessional financing terms and the importance of longer-term structural challenges in the LIC context.[4] Trust Fund lending, established in 1976, set the financial terms—longer repayment period and a low interest rate—that are still used today for Poverty Reduction and Growth Facility (PRGF) and ESF lending. The Structural Adjustment Facility (SAF) created in 1986 explicitly recognized that structural weaknesses could contribute to balance of payments needs.

6. **The PRGF has long been at the center of the Fund's financial engagement with LICs.** Both the Enhanced Structural Adjustment Facility (ESAF, created in 1987) and its successor the PRGF (created in 1999 to give greater emphasis to growth and poverty reduction with programs based on country-owned Poverty Reduction Strategy Papers (PRSPs)) were intended to help countries address entrenched balance of payments problems through three-year programs covering macroeconomic policies and structural reforms. As essentially the only concessional facility available to LICs until recently, the PRGF has also

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[4] Box 1 in *The Fund's Support of Low-Income Member Countries—Considerations on Instruments and Financing* provides details on the early history of the Fund's concessional assistance. Legal issues relevant to providing Fund assistance to a subset of the membership based on per capita income are discussed in *The G-8 Debt Cancellation Proposal and Its Implications for the Fund.*

been used to help address shocks and policy slippages, and to signal to donors on the strength of macroeconomic policies. Satisfactory performance under a PRGF arrangement is generally a requirement for Heavily Indebted Poor Country (HIPC) debt relief (other facilities can be used but this is rare).

7. **LICs have also received financial assistance from the GRA, whose resources are available to all members.** Emergency assistance is available to countries hit by natural disasters (ENDA) or emerging from conflict (Emergency Post-Conflict Assistance (EPCA)). The Extended Fund Facility (EFF) has been an important tool for blending concessional and non-concessional resources in cases where a country is moving toward graduation from (income-based) eligibility for PRGF-ESF Trust resources or requires high access, for example to help clear arrears. The Stand-By Arrangement (SBA), which has been the main tool for Fund financial engagement in middle-income economies, has also been used by a few LICs for short-term stabilization needs (including when a medium-term macroeconomic strategy or PRSP was not in place) and to obtain access above PRGF limits.

8. **The Fund has sought to strengthen its toolkit to support LICs in their evolution from stabilization to sustainability (and thus reduced need for ongoing Fund financing).** By 2005, a number of LICs had made good progress—often supported under successive PRGF arrangements—toward sustained macroeconomic stability and stronger institutions, and had reached the completion point under the Enhanced (HIPC) Initiative. Several countries moved to low-access PRGFs as financing needs had declined while continued program engagement was sought to support macroeconomic policies and catalyze donor flows to help boost growth and reduce poverty. In 2005, when the Multilateral Debt Relief Initiative (MDRI) was approved to provide significant further debt reduction beyond HIPC, the Fund also established two new LIC tools: (i) the PSI to provide policy support and signaling for mature stabilizers seeking to implement an Upper-Credit Tranche (UCT) standard economic program[5] but not in need of Fund financial assistance and (ii) the ESF to provide rapid assistance in the event of an exogenous shock for countries without a PRGF arrangement in place. With no ESF requests through early 2008, the facility was modified last September and the first requests under this facility have now been approved.[6]

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[5] While there is no explicit definition, a UCT standard program generally refers to a set of policies that are adequate to correct balance of payments imbalances and enable repayment to the Fund.

[6] The main modifications were: (i) allowing the ESF to be used at the same time as a PSI, (ii) not requiring a PRSP, (iii) creating a new Rapid-Access Component under which countries hit by exogenous shocks could receive up to 25 percent of quota more quickly, and (iv) establishing a higher normal limit of 75 percent of quota for the ESF's High-Access Component (*Proposed Reforms to the Exogenous Shocks Facility*).

Table 1. IMF Facilities Available to Low-Income Member Countries[1]

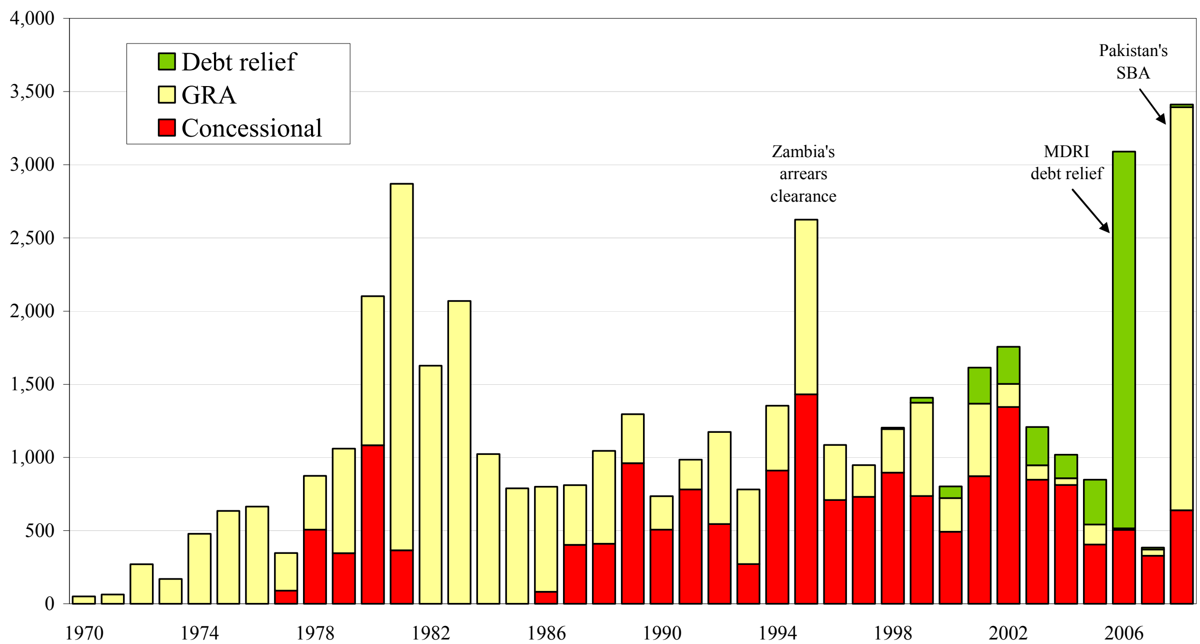
Facility / Policy	***Source of Finance***	***Purpose***	***Access*** *(percent of quota)*	***Terms*** *(interest rate and repayment period)*
PRGF	PRGF-ESF Trust	Longer-term assistance for deep-seated balance of payments need of structural nature; aims at poverty reducing growth through 3 year UCT[2] program based on country-owned PRSP (extension to 4 years possible).	Max. of 140 or 185 in exceptional circumstances plus norms for successive arrangements	0.5 percent 5½ - 10 years
ESF – Rapid Access		Rapid assistance (usually in a single disbursement) for exogenous shocks on the basis of a commitment to appropriate policies. Not UCT.	Max. 25	0.5 percent 5½ - 10 years
ESF – High Access		Assistance for exogenous shocks through a 1-2 year UCT program.	Norm of 75, no ceiling	0.5 percent 5½ - 10 years
ENDA	General Resources Account [3]	Rapid assistance in the event of a natural disaster. Single purchase. Not UCT.	Norm of 25, max. of 50	Rate of charge / 0.5 percent (subsidy resources permitting) 3¼ - 5 years
EPCA		Assistance over a period of up to 3 years to countries emerging from conflict. Not UCT.	Norm of 25, max. of 50 with max. of 25 per year	Rate of charge / 0.5 percent (subsidy resources permitting) 3¼ - 5 years
SBA		Short-term assistance based on 1-2 year UCT program for short-term balance of payments needs (3 year program possible).	Annual limit of 100 and cumulative limit of 300 although exceptional access possible	Rate of charge + surcharge for high access 3¼ - 5 years
EFF		Longer-term assistance to support structural reforms through a 3 year UCT program.	Annual limit of 100 and cumulative limit of 300	Rate of charge + surcharge for high access 4½ - 10 years
CFF		Medium-term assistance for temporary export shortfalls or increased cereal import costs.	Limit of 45 (exports or cereal) or 55 if combined	Rate of charge 3¼ - 5 years
TIM	GRA or PRGF-ESF Trust	Additional assistance under existing UCT program for balance of payments need due to multilateral trade liberalization.	Determined by UCT program to which TIM policy is applied	
PSI	Non-Financial	Policy support under UCT program for countries that are mature stabilizers and do not need or want Fund financial assistance.	n.a.	n.a.

[1] Excludes Staff-Monitored Programs (SMPs), which are not approved by the IMF's Executive Board.
[2] Upper-credit tranche quality.
[3] GRA repayment periods reflect obligations schedules.

B. Usage of the Fund's Facilities by LICs

9. **LICs have made extensive use of the IMF's concessional facilities over the past two decades, and many have also benefited from debt relief (Figure 1).** More than four-fifths of the 78 PRGF-eligible members have received IMF financing,[7] with arrangements in place for an average of 11 of the past 21 years per country. Three-quarters of all LICs have been supported under the PRGF/ESAF; on average there have been almost three such arrangements per user. Financing from (non-concessional) GRA resources and (subsidized) emergency assistance was also substantial, but more concentrated among a few users. Total disbursements from 1987 to 2008 amounted to SDR 26.4 billion, of which SDR 15.6 billion was on concessional terms. The Fund has also disbursed SDR 1.7 billion in HIPC Initiative assistance to 34 members and SDR 2.3 billion in MDRI assistance to 25 members.

Figure 1. Fund Lending and Debt Relief to PRGF-Eligible Countries, 1970-2008 1/
(In millions of SDRs)



Source: Finance Department.
1/ Includes GRA purchases, PRGF/ESF disbursements, and HIPC/MDRI debt relief; excludes GRA purchases by China (which was PRGF-eligible through end-2000) and India.

10. **Disbursements have trended down until recently, but the number of countries with Fund-supported programs, including through low- and no-access instruments has remained broadly stable (Figures 2 and 3).** Disbursements under all facilities fell from SDR 8.1 billion for 1989-93 to SDR 5.8 billion for 2004-08, with a notable regional shift away from East and Southeast Asia and toward Africa and low-income transition economies

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[7] The remainder are primarily small islands with relatively high per capita income.

in Eastern Europe and Central Asia. During these two periods, the average number of Fund-supported country programs stayed at about 38. These trends have reflected: (i) improved economic performance of most LICs (see Section II.C); (ii) a relatively favorable global environment, with strong world growth and a sharp increase in private financing to LICs during 2003-07; (iii) debt relief through HIPC and MDRI;[8] (iv) declining access norms for repeat PRGF users (see Section V.A); and (v) increased demand for program engagement with the Fund through low-access and non-financing facilities (low-access PRGFs and PSIs) to support macroeconomic policies and catalyze donor support.

Figure 2. Total Disbursements and World Growth *

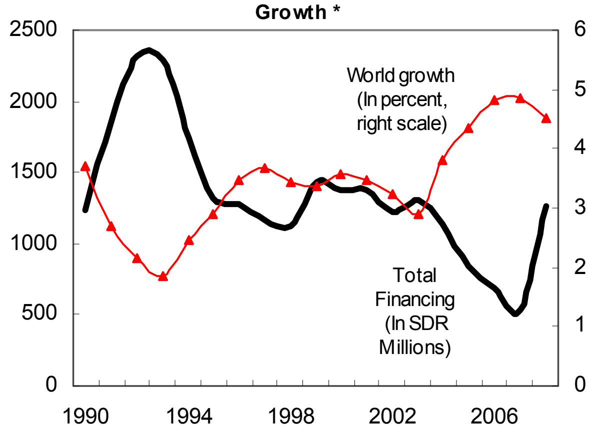
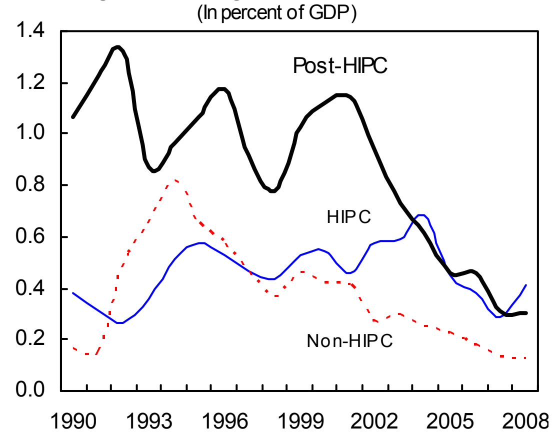


Figure 3. Average IMF Disbursements *
(In percent of GDP)



Sources: International Monetary Fund; IFS database, FIN database, WEO database, SPR database, and IMF staff calculations.
* Three-year moving averages; disbursements exclude financing-repurchases for Zambia (1995), and Liberia (2008).

11. **Recent global volatility has led to a spike in LIC demand for IMF financial assistance, with the number of new financing requests jumping from 5 in 2007 to 23 in 2008.**[9] In addition, there were 12 augmentations of access under PRGF arrangements in 2008, reflecting in part the surge in food and fuel prices. Total disbursements to LICs from the PRGF-ESF Trust and the GRA increased from SDR 330 million and SDR 40 million, respectively in 2007, to SDR 640 million and SDR 2.8 billion in 2008 (the latter including SDR 2.1 billion to Pakistan).

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[8] Many LICs faced high debt service burdens in the 1980s and 1990s, necessitating successive Paris Club rescheduling agreements, combined with ESAF/PRGF arrangements. As shown in Figure 3, countries that have reached the HIPC completion point (initially the heaviest ESAF/PRGF) users, have required less IMF financing in recent years, reflecting a reduced debt service burden and no further need for Paris Club debt treatments.

[9] Nine PRGFs, four ESFs, four EPCAs, three SBAs, two ENDAs, and one EFF were approved in 2008.

C. Economic Performance

12. **Countries that have made extensive use of IMF facilities have experienced a marked improvement in long-term economic performance.** While macroeconomic indicators have improved for many LICs, those under IMF financial arrangements for at least 10 of the past 20 years showed on average more significant increases in long-term growth, exports, and foreign director investment (FDI), while also achieving a more noticeable reduction in inflation, external debt, and current account and fiscal deficits than countries with little or no program engagement (Figure 4). As a result, countries with longer-term engagement have largely closed the performance gap with other LICs that existed when the ESAF was created. While more analysis is needed,[10] this could lend support to the view that intensive IMF program engagement may have been conducive to a long-term improvement in macroeconomic conditions in many cases, not only by relaxing financing constraints, but also by facilitating debt relief, building macroeconomic management capacity, and catalyzing donor support (see Section III.A).[11]

13. **Nonetheless, the majority of LICs are still undergoing medium- or longer-term adjustment.** At end-2007, about one-third of PRGF eligible countries had established a medium-term track record of satisfactory economic growth, moderate inflation, manageable fiscal and current account deficits, adequate reserves, sustainable debt, and basic macroeconomic policy capacity.[12] At the same time, many countries are not yet in sustainable macroeconomic positions, including about one-third of PRGF-eligible countries that are still considered relatively fragile.

14. **Further progress is also needed on poverty reduction, notwithstanding recent improvements in social spending and human development indicators.** The introduction of PRSPs as the anchor of a country's medium-term economic and social strategy has helped focus economic policies, reforms, and donor support on the areas most vital for economic growth and poverty reduction. Fund-supported programs have increasingly included explicit targets aimed at safeguarding priority spending on health, education, and vital infrastructure. Nevertheless, urgent action continues to be needed to help LICs meet the Millennium Development Goals (MDGs) by 2015 (see Global Monitoring Report (GMR) 2008).

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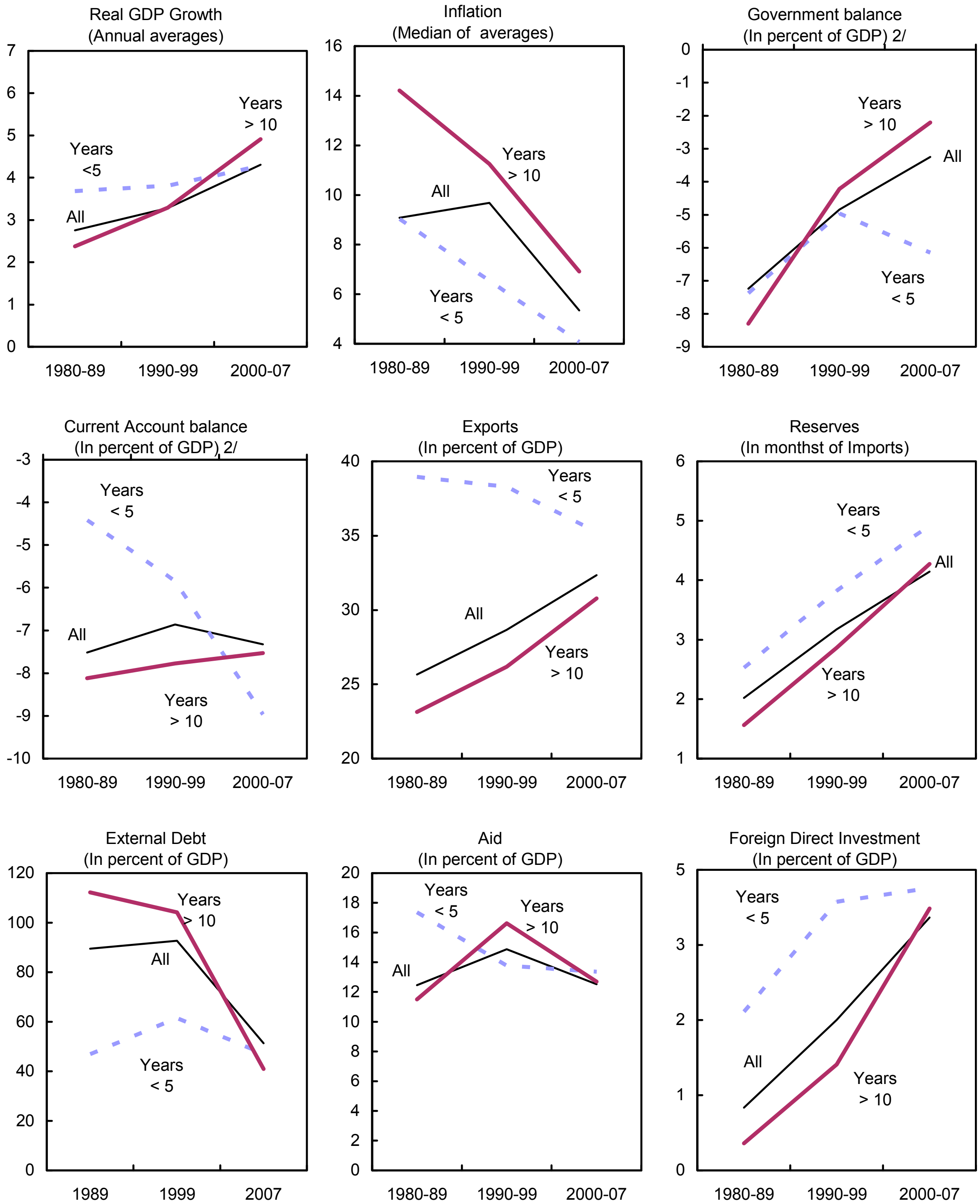
[10] While omitted variable bias could play a role, the finding is relatively robust across different sub-groups (geographical, capacity, debt relief status, and initial conditions) and is apparently not driven by differences in terms of trade or transmission of world growth. It also continues to hold for alternative definitions of extensive and infrequent program use. The relatively poor initial conditions of extensive program users may be an explanatory factor, as economic policy gains may have had a relatively large impact for these countries.

[11] In contrast to much of the literature on the impact of IMF-supported programs, this analysis focuses on the long-term impact of repeated IMF program engagement in LICs, where capacity building and debt relief play a critical role in gradually strengthening macroeconomic management and performance.

[12] These countries are often called "mature stabilizers." See forthcoming Supplement for methodological details.

Figure 4: LICs with extensive IMF program engagement have experienced, on average, a comparatively strong improvement in macroeconomic indicators, while starting from worse initial conditions. 1/



Sources: International Monetary Fund; WEO, IFS, World Bank Databases; and IMF Staff estimates.
1/ Unweighted averages, including for countries with IMF financial arrangements in place for more than 10 years since 1988, and those with less than five years. Excludes fuel-exporters and countries with inadequate historical data series (Albania, Afghanistan, Armenia, Georgia, Kyrgyz Republic, Liberia, Moldova, Mongolia, Tajikistan, Timor-Leste, Somalia, Tonga, and Uzbekistan).
2/ Including grants.

III. The IMF's Lending Role in LICs—Analytical Considerations

15. **IMF financing provides temporary balance of payments support to smooth economic adjustment toward a sustainable external position.**[13] A balance of payments need can arise from macroeconomic imbalances caused by exogenous shocks, policy slippages, or structural weaknesses. Fund financing in effect provides members with an intertemporal smoothing mechanism to help avoid excessive near-term adjustment (income contraction through monetary/fiscal tightening, increase in the private saving-investment balance, and/or real exchange rate depreciation), with the understanding that the resources are repaid as the economy recovers and macroeconomic stability is restored, which helps preserve the revolving nature of Fund resources.

16. **IMF lending to LICs also seeks to smooth adjustment, but has been adapted to reflect their particular circumstances.** These have included: (i) entrenched macroeconomic and structural imbalances, implying longer-term adjustment needs; (ii) an emphasis on reconciling adjustment policies with the need to raise economic growth and reduce poverty; (iii) aid dependence and the catalytic role of Fund-supported programs; (iv) excessive debt and high vulnerability to shocks; (v) an explicit link between HIPC debt relief and Fund arrangements, especially the PRGF; and (vi) extensive policy advice and technical assistance needs. These factors have argued for intensive program engagement, maintaining both a short- and medium-term concessional financing capacity, and facilitating adjustment toward a sustainable macroeconomic equilibrium with higher growth and lower poverty.

A. What are the Adjustment and Financing Needs of LICs?

17. **For many LICs, the required adjustment process is long, reflecting entrenched macroeconomic imbalances and structural challenges.**[14] These have included (i) a low-growth "trap" often caused by weak capacity, poor governance, conflict, poor infrastructure, and/or distance to markets; (ii) high and variable inflation, partly due to high exposure to world commodity prices and adverse weather conditions; (iii) a narrow revenue base, resulting in inadequate spending, large fiscal deficits, and budgetary arrears; (iv) large underlying balance of payments disequilibria, often characterized by weak exports, import compression, inadequate reserves, and external arrears; and (v) excessive public debt. Most LICs have faced several of these challenges, and PRGF lending has been based on a "protracted balance of payments problem" standard, as discussed in Section V.C. Many LICs have recently moved toward more sustainable macroeconomic positions, often supported by repeated IMF program engagement, but the adjustment process has been long (Figure 5).

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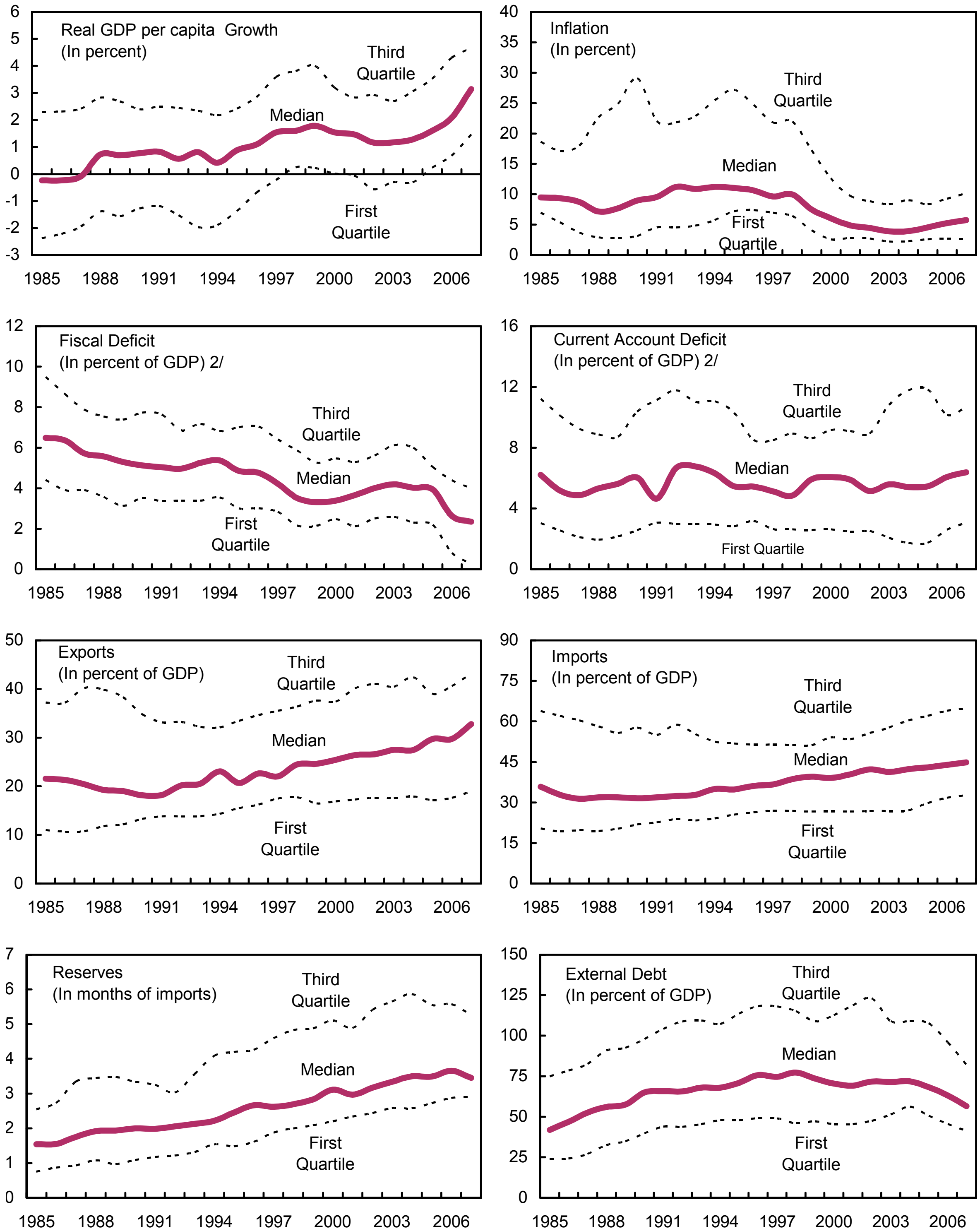
[13] This principle for the use of the Fund's general resources is anchored in Article I (v).

[14] Protracted adjustment needs have also occurred in other countries, for instance in the transition context in the 1990s. In some cases, these countries were supported by the three-year (non-concessional) EFF.

Figure 5. Macroeconomic adjustment has been a long process in most LICs.
(Five-year Moving Averages) 1/



Sources: International Monetary Fund; WEO database, and IMF staff calculations.
1/ The figure shows the macroeconomic adjustment for the median, first quartile, and third quartile of a group of LICs that excludes oil exporters and transition economies. In this regard, it hides dramatic reversals or improvements that individual countries have suffered at business cycle frequencies.
2/ Including grants.

18. **In addition, like other countries, LICs may also face short-term adjustment and financing needs caused by shocks and policy slippages.**[15] LICs are particularly vulnerable to oil, food, and other commodity price swings, given high oil import-to-GDP ratios, high shares of food in the consumer basket, and limited export diversification. Many are also exposed to shortfalls in aid or remittances, and some to private capital volatility. IMF financing to address shocks and policy slippages has been mainly provided through the PRGF (often through augmentations), but also under the SBA, and more recently the ESF in case of exogenous shocks. Financing needs stemming from natural disasters are common among LICs. And post-conflict states often require urgent balance of payments support, typically provided through the EPCA, to prevent a deterioration of economic conditions.

19. **Aside from immediate financing needs, countries can benefit from program engagement with the Fund in terms of policy support, capacity building, commitment, insurance, and signaling.** These factors argue for providing low- or non-disbursing program support, for instance through low-access PRGF arrangements, precautionary arrangements, or non-financial program instruments (such as the PSI), even when immediate financing needs are limited or absent.

- **Capacity/policy support:** Institutional capacity is still not well-advanced in most LICs, limiting the authorities' ability to sustain strong macroeconomic policies and structural reforms. Fund technical assistance and training have helped build capacity, and are typically closely integrated with Fund program work.[16] In addition to formal technical assistance, the Fund's program (and near-program) engagement itself, including through missions and resident representatives, builds macroeconomic management capacity through in-depth policy and technical discussions.[17]

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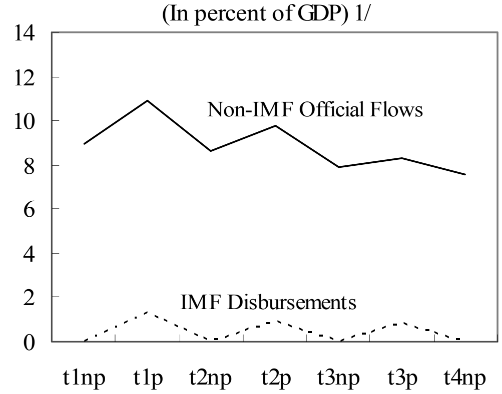
[15] A survey of IMF mission chiefs for LICs indicates that about three quarters of low-income countries presently have a balance of payments need. Of these, 40 percent have both a long-term and one of several types of short-term needs; 30 percent have a long-term need only; and 25 percent have a short-term need only. In addition, several countries had a precautionary need (see forthcoming Supplement). In this paper, "short term" refers to two years or less and "medium- or longer-term" to three years or more.

[16] A new policy on country contributions to Fund technical assistance (TA) will apply from May 2009. Countries with Fund financial arrangements will be exempted from the contributions policy since TA is often important for the success of programs by helping countries strengthen their institutions and implement program conditionality, which in turn helps safeguard Fund resources. The exemption will, however, not apply to LICs without arrangements or with non-financial PSIs or SMPs. The Fund is also stepping up fundraising, including for Regional Technical Assistance Centers and topical trust funds, which will likely benefit LICs.

[17] Several Ex-Post Assessments found a positive impact of longer term program engagement on members' strength of domestic institutions and technical capacity. See *Review of Ex Post Assessments and Issues Relating to the Policy on Longer-Term Program Engagement*.

- **Commitment device:** As in the case of Fund financing under the GRA, Fund concessional arrangements and associated conditionality can help LIC members build commitment around their economic policies and objectives, and can facilitate policy coordination within the government and with donors.

Figure 6. IMF disbursements and other official financing flows tend to co-move.
(In percent of GDP) 1/



Sources: International Monetary Fund; WEO database, Dorsey et al (2008) database, and IMF staff calculations
1/ Average annual disbursements since (1987) during successive (t1, t2, ...) program (p) and non-program (np) periods.

- **Insurance:** With increasing exposure to private (domestic and external) financing, demand is likely to grow for contingent Fund support. While there is currently no concessional precautionary instrument, low-access PRGF arrangements have played this role indirectly with the understanding that access can be easily augmented, while an on-track PSI could enable relatively rapid approval of an ESF if needed.

- **Signaling/catalytic effect:** IMF arrangements can help inform donor decisions and catalyze grants and concessional loans (on average, official inflows have been higher by about 1¼ percent of GDP in the presence of a Fund program, Figure 6). For LICs with market access, a Fund-supported program can also provide comfort to investors.

B. What is the Role of Concessional IMF Lending Relative to Donor Support?

20. **The significant debt-related vulnerabilities of LICs argue for providing IMF financing on concessional terms, subject to an overall resource constraint.** The experience of the 1970s/1980s has underscored the risk of borrowing on non-concessional terms. Many LICs, including post-HIPC countries, are at moderate-to-high risk of debt distress based on IMF-World Bank debt sustainability analyses, and many countries remain vulnerable to re-emergence of debt problems, given uncertain economic growth prospects and limited room for fiscal maneuver in case of shocks. Facilities for LICs are therefore based on concessional terms. Given limited total concessional resources administered by the Fund, access is rationed through norms and limits (see Section V.A), and concessional financing is blended with GRA resources for higher-income borrowers, countries with market access, and very large financing needs (see Section V.B).

21. **Notwithstanding its concessionality, the role of PRGF financing is distinct from development aid provided by multilateral development banks and bilateral donors:**

- ***Macroeconomic stability focus:*** While IMF-supported programs share many of the long-term goals of development assistance provided by others (notably higher growth and lower poverty), the Fund's unique and specific contribution to meeting these goals is to help members address macroeconomic imbalances and risks through appropriate policies, macro-critical structural reforms, and related capacity building.

- ***Intertemporal smoothing to support adjustment:*** Aid typically aims at increasing the long-term resource envelope of the recipient country, enabling permanently higher levels of consumption and investment.[18] By contrast, IMF financial assistance to LICs, while concessional, is primarily intended to provide a temporary resource transfer that permits intertemporal smoothing of absorption (even though in LICs, the adjustment can be long), cushioning the degree of adjustment needed. Also, while aid should usually be provided on a steady and predictable basis to reduce volatility (except in emergencies), IMF lending is generally counter-cyclical.

- ***Crisis response:*** The Fund often plays a key role in crisis situations, being able to provide speedy financial support while coordinating closely with other partners that may scale up their support more gradually.

- ***Balance of payments and fiscal impact:*** Aid should generally be both fully spent and absorbed over the medium term, i.e., used for higher fiscal spending and imports. By contrast, IMF loans can be partly (or even fully) saved when reserves are low, to provide a cushion against potential macroeconomic volatility.[19] Moreover, most forms of development assistance are targeted at particular spending areas, whereas Fund assistance is aimed at general balance of payments support.

- ***Signaling/catalytic effect:*** As discussed above, performance under an IMF financial arrangement can be an important signal to donors.

[18] Grant-financed aid is a permanent resource transfer from the donor to the recipient. Concessional loans entail both a permanent resource transfer (equivalent to the embedded grant element) and a temporary transfer (equivalent to the present value of total debt service). Concessional loans provided by development agencies are often intended to finance projects that generate an economic return that provides the resources out of which the debt service can be paid. By contrast, the interest rate subsidy for PRGF-ESF loans is primarily intended to prevent future debt problems, rather than enhancing the long-term resource envelope of the recipient.

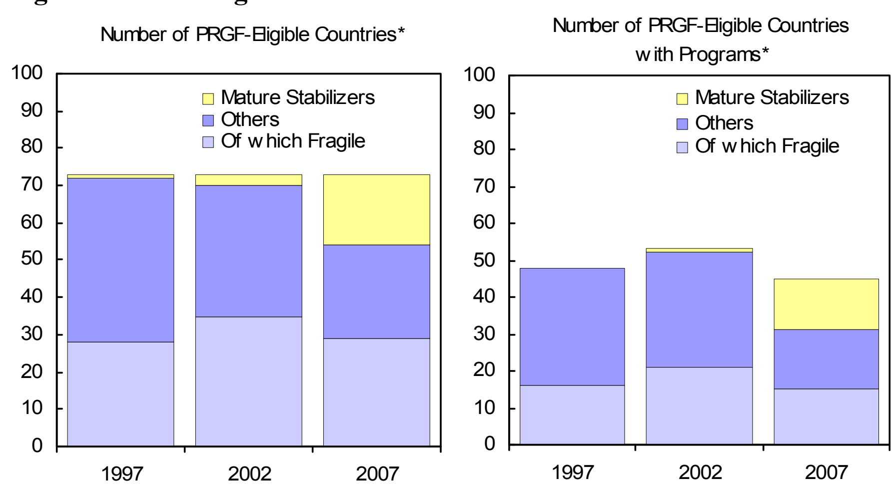
[19] In principle, IMF financing and development assistance provided by others can have the same impact on spending and absorption. Both an IMF loan and budget support (grant or loan) by donors are in effect balance of payments support as they provide the recipient with foreign exchange. Both can be fully spent and absorbed, which in the case of the IMF would involve additional steps, such as a central bank credit to the government, or more indirectly, a monetary expansion that allows the government to borrow from domestic banks. Other possible combinations of spending and absorption (including full saving) can in principle be replicated for both types of support through appropriate monetary policies. The main difference is that aid should *usually* be fully spent and absorbed (see *The Macroeconomics of Managing Increased Aid Inflows—Experiences of Low-Income Countries and Policy Implications*, while IMF financing should *often* be neither fully absorbed nor fully spent. Another difference is that repayment of an IMF loan occurs earlier than most concessional loans, implying an earlier and larger unwinding of spending and absorption.

C. The Need for a More Flexible Set of LIC Instruments

22. **The Fund's toolkit of instruments for LICs has been broadly adequate until recently, but circumstances are changing.** As discussed in Section II.C, concessional medium-term financing under the PRGF, aligned with country-owned PRSPs, has accompanied a marked improvement in economic performance over the past two decades. However, the toolkit may now need to be adapted to ensure that the Fund can serve the increasingly diverse needs of its LIC members in the face of their heightened exposure to global volatility, as put into sharp focus by the ongoing global economic crisis.

23. **LICs have become increasingly diverse, with some still in highly fragile situations but others sustaining strong policies and gaining market access.** In the 1990s, the vast majority of LICs required medium- or longer-term adjustment (in many cases coupled with debt relief), whereas now more than a quarter are in broadly sustainable macroeconomic positions (Figure 7). At the same time, a majority of LICs continue to face entrenched adjustment needs, including about a third that are still in a fragile situation. As LICs continue to advance, and integrate into the world economy, their challenges will increasingly resemble those of emerging market countries, with more episodic, short-term financing needs, although they may continue seeking program-based engagement as long as they remain dependent on foreign aid and can benefit from macroeconomic policy support.

Figure 7. PRGF-eligible countries have become more diverse over time.



Sources: International Monetary Fund; WEO, IFS, World Bank Databases; and IMF Staff estimates.
* The list of countries excludes countries with inadequate long-term historical data series.

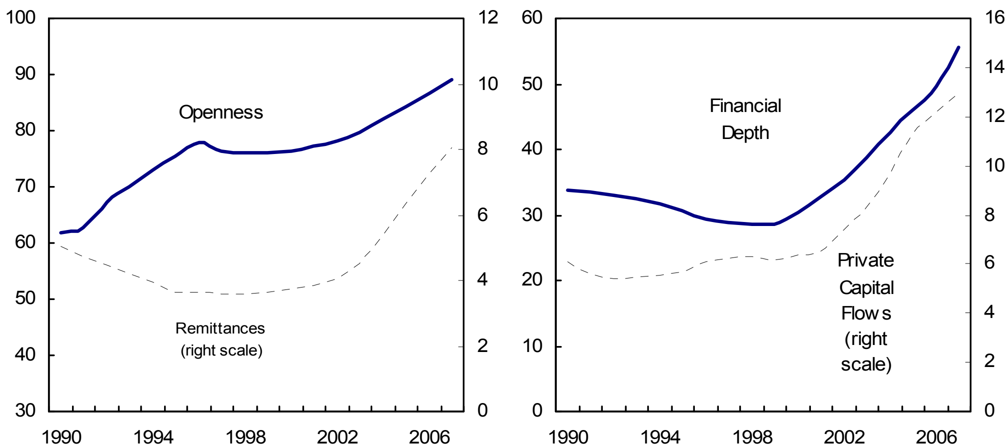
24. **At the same time, LICs are becoming increasingly exposed to global volatility, and many are being hit hard by the global economic crisis.** Private capital inflows and FDI have risen sharply in recent years,[20] making some countries vulnerable to sudden stops

[20] Dorsey, Thomas, Helaway Tadesse, Sukhwinder Singh, and Zuzana Brixiova, 2008, *The Landscape of Capital Flows to Low-Income Countries,* IMF Working Paper 08/51.

similar to those experienced by emerging market countries. Many LICs have also become increasingly exposed to commodity price volatility as trade shares in GDP have risen and global volatility has trended up (Figures 8 and 9). At the same time, some countries have become more dependent on inflows of aid and remittances, making them vulnerable to possible reversals. As local financial sectors have grown, external shocks may be amplified in case of domestic financial fragilities. As discussed in the forthcoming Fund staff paper on *The Implications of the Global Financial Crisis for Low-Income Countries*, LICs have been severely affected through lower demand for their exports, the sharp decline in commodity prices, lower remittances, and reduced FDI.

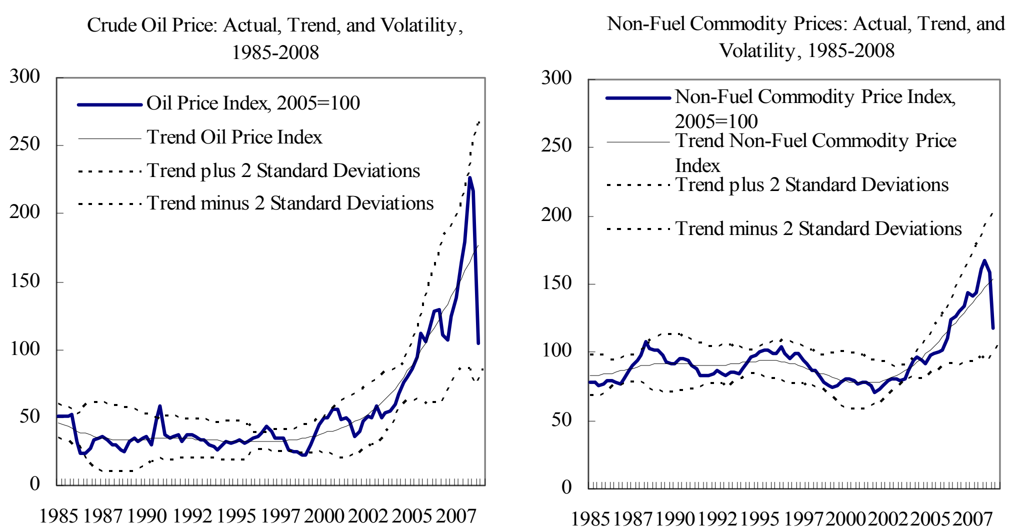
Figure 8. LICs have become more exposed to global volatility.

(Five-year moving averages, in percent of GDP)*



Source: International Monetary Fund; WEO database, World Bank (2008), and IMF staff calculations.
* Openness is measured as total trade (exports plus imports) in precent of GDP. Financial depth is measured as M2 in percent of GDP.

Figure 9. Commodity price volatility has increased in recent years.



Sources: International Monetary Fund; WEO database, World Bank (2008), and IMF staff calculations.

25. **To preserve the hard-won economic gains LICs have made over the past two decades, the Fund's facilities and financing framework will need to become more flexible in light of LICs' diverse needs and heightened exposure to global volatility.** A range of reform areas will be considered in the following sections:

- **Gaps and overlaps in the facility architecture:** While medium-term (PRGF-type) financing will remain an appropriate vehicle to address the needs of LICs with medium- or longer-term adjustment needs, there may be a relative shift of demand toward more episodic, short-term and emergency financing, and precautionary arrangements. As discussed in Section IV, gaps remain in these areas, increasingly constraining the Fund's ability to assist its LIC members effectively.

- **Access limits and norms:** As discussed in Section V.A, access limits have been eroded and may now be too low for assisting LICs that have become more exposed to a world economy with greater volatility.

- **Financing terms:** As discussed in Section V.B, to balance the need for concessional financing with a limited resource envelope, there is a case for making emergency assistance for LICs more concessional, further clarifying rules for blending concessional and GRA resources, and more regularly reviewing PRGF eligibility.

- **Conditionality:** The growing diversity of LIC adjustment needs argues for a moving toward a more tailored and flexible application of conditionality (Section V.D).

- **Concessional resource envelope and financing framework:** As discussed in Section VI, demand for Fund concessional financing is expected to double over the medium term, implying the need to secure additional concessional resources. Section VII discusses how changes to fund-raising and the trust fund structure could make the concessional financing framework more flexible and efficient.

IV. Facilities Architecture

26. **The Fund's LIC-specific facilities have generally worked well, but gaps and ambiguities remain, constraining the Fund's ability to respond effectively to LIC needs in the context of increasing global volatility.** As noted above, the PRGF has contributed to a marked improvement in long-term economic performance. However, LICs' circumstances have become increasingly diverse, from countries with fragilities and limited capacity to pre-

emerging markets with greater exposure to global volatility. This underscores the need for considerable flexibility in the Fund's facilities for LICs.[21]

27. **The PSI and ESF have been established to close perceived gaps.** The PSI was intended to provide policy support to LICs that may still be dependent on donor support but not in need of financial assistance from the Fund. Experience has been broadly positive so far, as discussed in a forthcoming review, and several LIC members are likely to request PSIs over the next few years. With regard to the ESF, demand has grown following design modifications in late 2008, but initial cases have raised some questions over qualification criteria, measurement of shocks, access, blending with other facilities, and use relative to other instruments. And despite these new tools, several important gaps remain.

A. Gaps

28. **Three notable gaps can be identified in the Fund's concessional facility architecture: (i) a flexible short-term financing instrument; (ii) a precautionary instrument; and (iii) a flexible emergency financing instrument, including for LICs in fragile situations.** Executive Directors have highlighted these gaps on several occasions. They have also been underscored by recent country cases and in a survey of IMF mission chiefs' experiences and interactions with country authorities over the past few years.[22]

29. **The Fund's ability to address short-term concessional financing needs remains limited, even after modification of the ESF; this gap may become increasingly problematic as LICs become more exposed to volatility.** As LICs make economic progress, risks related to increased international integration and domestic financial market liberalization will intensify, and demand for shorter-term financing is likely to increase.

- The **ESF** provides a short-term concessional option to address exogenous shocks, but does not cover financing needs arising from domestic problems such as policy slippages, banking troubles, or a decline in public confidence. Moreover, in practice it can be difficult to disentangle exogenous and endogenous contributions to balance of payments pressures.

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[21] Executive Directors looked to this review to ensure that the Fund's instruments continue to meet the evolving needs of LICs and to consider issues such as flexibility in the PRGF as well as the possibility of a precautionary window, and the creation of a Stand-By-type instrument to support short-term stabilization in LICs.

[22] The survey of mission chiefs (forthcoming Supplement) indicates that these gaps may be relevant in a non-negligible number of countries: short-term financing needs are expected in 37 percent of countries included in survey responses; precautionary needs in 31 percent of countries; and financing for non-post conflict fragile states and/or flexible emergency financing in 39 percent of countries. Mission chiefs also report that some country authorities, donors, and NGOs noted these gaps. Another gap perceived by mission chiefs was the lack of a pure signaling and policy support instrument for non-mature stabilizers without a financing need.

- The **PRGF** is designed to help eligible members address protracted balance of payments problems. It requires a three-year program, thus potentially tying up scarce concessional resources for longer than necessary in countries with shorter-term needs. It also requires a PRSP, which often takes considerable time to prepare. In addition, members that have stopped using the PRGF (and moved to a PSI or surveillance-only engagement) may be reluctant to return to a facility primarily targeted at members with protracted balance of payments problems and longer-term adjustment needs, and perceived as linked to poverty reduction and HIPC debt relief.

- Recent country experience suggests that the lack of an appropriate short-term concessional instrument may induce some countries to opt for financial assistance under non-concessional **SBAs**, which could significantly raise near-term debt service burdens.[23]

30. **Precautionary arrangements are likely to become more important as LICs have become more integrated into global markets and are developing their financial sectors.** Countries that encounter increased volatility and risks related to access to world capital markets or domestic financial sector reforms may wish to have a precautionary arrangement to instill confidence and provide quick access to finance should conditions deteriorate. As exports grow, countries will also become even more exposed to volatility of commodity prices and global growth. The combination of more integrated LICs and a more unsettled global financial environment could create significant near-term demand for precautionary arrangements among LICs. Precautionary SBAs are a central element of the Fund's GRA architecture, and have worked well for many middle-income members. In the absence of a concessional precautionary instrument, some LICs have turned either to (non-concessional) precautionary SBAs or low-access PRGFs (the PRGF generally has not been considered an appropriate instrument for precautionary use, but can be augmented quickly).[24] However, to the extent that countries are not yet ready to rely primarily on non-concessional financing, SBA terms may not be appropriate for LICs in the event drawings are needed. Also, the signal sent by a low-access PRGF arrangement is unlikely to be optimal for mature stabilizers seeking to keep or gain market access, and the three-year term may be longer than desired.

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[23] SBAs have been approved recently for PRGF-eligible countries such as Georgia, Pakistan, and Honduras. Several additional cases are expected to be considered soon. Access levels, PRSP requirements, demand for precautionary financing, income levels, and stigma may have been factors in some cases.

[24] Honduras indicated that it would treat its SBA as precautionary. During the 2004 discussion of *The Fund's Support of Low-Income Country Member Countries—Consideration of Instruments and Financing*, a precautionary PRGF was considered inappropriate, in part because it would tie up concessional resources and is at odds with the protracted balance of payments problem standard for PRGF lending.

31. **The lack of a flexible mechanism to deal with emergencies in countries affected by fragility and limited policy capacity has been noted on a number of occasions.** At times, countries face emergency adjustment and financing needs when their policies do not meet UCT standards, possibly due to external arrears, periods of political transitions, or fragile situations.[25] In these circumstances, Fund financial assistance, with its policy support and catalytic effects, can sometimes be critical to support economic policies and forestall a precipitous deterioration in economic and social conditions that might undermine prospects for progress. Currently, the Fund cannot provide this assistance unless the country recently experienced a conflict (and qualifies for EPCA), a natural disaster (and qualifies for ENDA) or an exogenous shock (and qualifies for the ESF's Rapid-Access Component (RAC)).

B. Overlaps

32. **At recent Board discussions of LIC financing requests, questions have been raised about the appropriate choice of instrument and the relationship between different instruments.** Some uncertainty is to be expected when new instruments such as the ESF and PSI are introduced, where the PRGF had once served nearly all financing and policy support functions. Still, the confusion that has arisen on the appropriate use of the PRGF, ESF, PSI, SBA, EPCA, and ENDA (including on combining some of these instruments) is one indication that a more streamlined architecture may be needed.[26] At the same time, retaining flexibility will be important, including to: (i) provide effective assistance in the wide range of circumstances encountered by LICs and (ii) take into account the authorities' assessment of the appropriate instrument.

33. **Overlaps have become particularly acute for instruments that can help address shocks.** A LIC member that is hit by an exogenous shock could seek an augmentation under an existing PRGF arrangement or a new PRGF (if none is in place), the RAC or High Access Components (HAC) of the ESF, a non-concessional SBA, or Emergency Assistance (under ENDA for a natural disaster, under EPCA for qualifying post-conflict countries, or under the Compensatory Financing Facility (CFF) for an export shortfall or rise in cereal import costs). Some overlaps may be inevitable, for instance because all Fund members have access to

[25] The broader question of how the Fund should engage with fragile states was discussed in *The Fund's Engagement in Fragile States and Post-Conflict Countries—A Review of Experience—Issues and Options*. The gap highlighted above is only one aspect of a possible broader strategy on fragile states, which would typically have a strong technical assistance component. The gap also applies to states not considered fragile but experiencing a period of emergency needs not caused by conflict or exogenous shocks.

[26] For example, questions were raised in a few cases on whether the PRGF or the ESF would be more appropriate in light of the nature of the country's adjustment need. Moreover, questions have arisen about moving from a PSI to a PRGF, combining the ESF and the EPCA, and use of the SBA by LICs.

GRA resources, but there seems to be scope for reducing the number of facilities for shocks and emergencies. The CFF stands out as a little-used facility that might be eliminated.[27]

34. **Additional factors contribute to ambiguity in the choice of instruments.** First, assessing qualification criteria can be challenging. For instance, in the case of the ESF, determining the exogenous and endogenous components of a balance of payments deterioration can be difficult, in particular given the data limitations and time lags prevalent in LICs.[28] Similarly, determining whether a country's balance of payments need is short- or longer-term is not always straightforward, as countries may have both underlying balance of payments weaknesses as well as more immediate needs. Also, differing program requirements, access limits, and financing terms across facilities and the possibility of combining facilities can create inconsistencies.

C. Reform Options for Consideration

35. **The above considerations suggest a need to strengthen the facilities architecture for LICs by closing gaps and reducing overlaps.** Without reform, the Fund would run the risk of (i) inducing an increasing number of LIC members to use non-concessional financing, thus adding to the near-term debt service burden, (ii) relying on concessional instruments to address some gaps in an *ad hoc* and inconsistent manner, and (iii) being unable to serve the needs of some members with any concessional instrument.

36. **Any reform of the IMF's LIC facilities should be forward-looking, with an architecture that can cover a variety of potential adjustment and financing needs for LICs.** Across all reform options, the following considerations should be taken into account for three broad types of country situations:[29]

- For countries whose **policies do not currently meet UCT standards**, concessional financing to address urgent balance of payments needs may be necessary in case of natural disasters, shocks, and emergencies in post-conflict or other fragile situations. Speed and flexibility in design will often be critical, whereas access would naturally be low, given the lack of UCT policy standards. Such financing can play an important

[27] See also: *Review of Fund Facilities—Analytical Basis for Fund Lending and Reform Options*.

[28] For instance, a terms-of-trade shock might coincide with loose fiscal policies, and qualification for the ESF would depend on a judgment of the extent to which the policy stance contributed to a balance of payments need.

[29] Movement among the three categories is expected, depending on country circumstances. While the Fund generally seeks to support progress by LICs toward macroeconomic stability and middle-income status, countries that have sustained macroeconomic stability for some time, such as PSI users, could develop a medium-term adjustment need appropriately met through a PRGF. Conversely, it is also possible that a post-conflict country that initially relies on emergency assistance might be able to move rapidly to a broadly sustainable macroeconomic position if capacity is strong.

role in (i) helping countries avoid excessive adjustment when hit by shocks, (ii) preventing a precipitous deterioration in economic and social conditions in fragile situations, (iii) catalyzing donor support, and (iv) facilitating a transition to a UCT facility.

- For **countries undergoing medium- or longer-term adjustment**, three-year (PRGF-type) financing is usually most appropriate since it can be aligned to the PRSP, which has often been successful in helping to build country ownership and donor support around medium-term economic frameworks aimed at raising growth and reducing poverty. It also gives assurances about sustained Fund financial support. Repeated support may be necessary if the underlying balance of payments problem is deeply entrenched, though it should not continue indefinitely. Occasional short-term financing needs arising from shocks or policy slippages are best addressed through augmentations of the medium-term arrangement. If such an arrangement is not in place and more time is needed to develop a PRSP-based framework, short-term financing might be used as a bridge toward a medium-term financing facility.

- For **countries in broadly sustainable macroeconomic situations**, short-term adjustment needs created by shocks or policy slippages are best supported through short-term financing. If the adjustment takes longer than initially projected, a successor arrangement, either short-term or if necessary medium-term, can be put in place. In the absence of an immediate financing need, countries may still benefit from precautionary arrangements or the PSI as signaling, policy support, and insurance instruments, which may be particularly important in countries with high aid dependence, evolving macroeconomic management capacity, and exposure to global volatility and private financing.

37. **In considering reform options, a number of broad principles and tradeoffs might be taken into account.** These include:

- **Streamlining versus greater tailoring of facilities:** A streamlined architecture with fewer instruments is generally simpler and could reduce overlaps. Against this, there is value in tailoring lending facilities to the diverse needs of LIC members in specific instances.

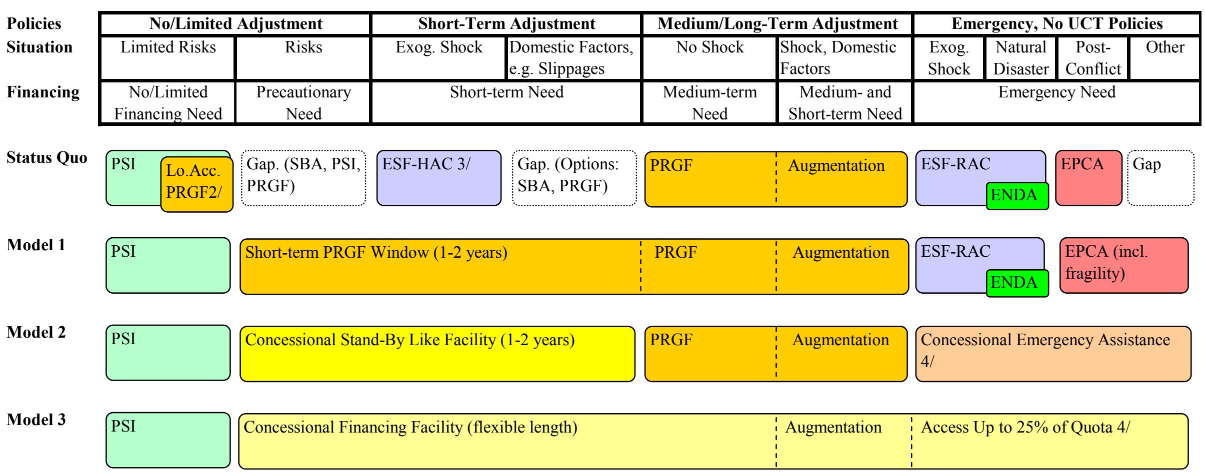
- **Targeting versus flexibility:** Overlaps among instruments could be reduced by defining more narrowly the circumstances in which instruments can be used. However, this may reduce flexibility in serving the evolving diversity of LIC needs; and more narrowly defined facilities (e.g., CFF or the initial ESF) have often been little-used relative to more flexible instruments (e.g., PRGF or SBA).

- **PRSP link:** Basing IMF-supported programs such as the PRGF and PSI on PRSPs has been successful in helping to build country ownership and donor support around medium-term economic frameworks aimed at raising growth and reducing poverty. At the same time, requiring a PRSP could be seen as onerous for some types of emergency and short-term financing, possibly delaying urgent assistance.

- **Symmetry with GRA facilities:** LIC facilities could mirror the structure of GRA instruments but on concessional terms, which could have advantages in terms of blending of concessional and non-concessional resources.

38. **Based on the above considerations, three broad reform models could be envisaged (Figure 10 and Table 2).** The first would make the PRGF more flexible to cover all circumstances with significant policy efforts (meeting UCT standards), while extending the use of EPCA to emergencies in fragile situations. The approach would be more streamlined than the status quo, allow some additional flexibility, and keep IMF-supported policies firmly focused on PRSP objectives. The second option would keep the PRGF unchanged, replace the ESF with a Stand-By-like concessional instrument, and create a streamlined emergency assistance instrument. This option would tailor facilities to the main country needs discussed above, increase flexibility in cases of shocks and emergencies, and limit PRSP requirements to the PRGF. The third model would create a single flexible facility for all needs. This approach would be the most streamlined and allow the greatest flexibility regarding design and social objectives.

Figure 10. LIC Facilities Architecture: Status Quo and Reform Options 1/



1/ Stylized Illustration. Does not include possible overlaps due to multiple events (e.g. a post-conflict country exposed also to a shock).
2/ Low-access PRGF arrangement, normalized at 10 percent of quota.
3/ Exogenous Shocks Facility, High Access Component. Can be used while PSI remains in place.
4/ Includes a Rapid Access Option, with limited or no policy adjustment for temporary shocks such as natural disasters.

39. **All options would close the three main gaps and—to differing degrees—reduce overlaps.** In all cases, the CFF could be eliminated and the PSI, discussed in the forthcoming review of the PSI, could remain as a zero-money policy support and signaling instrument for mature stabilizers. The Staff-Monitored Program (SMP) would continue to play its current role of helping members build policy capacity and a track record toward a UCT standard arrangement. Different approaches to program design elements such as access, financing

terms, and conditionality, as well as to the concessional financing structure, could be considered under any reform scenario.[30] All of these issues would be examined in greater detail in subsequent proposals following Executive Board discussion of the broad options on the architecture.

Option 1: More Flexible PRGF and Emergency Assistance

40. **Existing facilities could be made more flexible to close gaps, while leaving the PRGF as the centerpiece of the Fund's LIC architecture.** The PRGF could be modified to include a short-term window to address short-term needs caused by shocks and policy slippages in countries that do not have a three-year arrangement in place and are not in need of medium-term adjustment. The short-term window could also include a precautionary option. To reduce overlaps, the ESF could be limited to its RAC component, with limited, if any, conditionality. To provide more flexible concessional emergency support, eligibility for EPCA could be expanded to include non-post-conflict fragile situations.

- **Pros**: This option would reinforce the PRSP-based foundation of Fund financing and program support for LICs, which would keep the focus on growth and poverty reduction, and could facilitate donor coordination, where PRGF-supported macroeconomic frameworks have a well-established role and track record. It would represent a relatively streamlined structure in that there would be only one concessional facility supporting UCT quality policy adjustment, thus clearly delineating policy adjustment and emergency financing. The approach would permit some flexibility on the timing and nature of reforms of the architecture.

- **Cons**: The short-term PRGF window could create confusion as the PRGF is understood to be designed for entrenched balance of payments problems, and raise questions about the assessment of balance of payments need (see Section V.C). It would also risk negative stigma from the perspective of some potential users given the perceived association of the PRGF with poverty, growth, and debt problems. PRSP requirements under the short-term window could impede the Fund's ability to respond quickly. The approach would also leave some overlaps and ambiguities on exogenous shocks. Changes to the PRGF-ESF Trust could be complex, including due to linkages between the PRGF and the HIPC Initiative.

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[30] Principles for LIC access policy are considered in Section V.A. Repayment terms for concessional instruments are generally assumed to be those of the PRGF-ESF Trust although variations in this respect could also be considered (see Section V.B). The assessment of financing needs and conditionality are considered in Sections V.C and V.D respectively. The concessional financing structure is discussed in Section VII.

Option 2: Three-Pillar Structure: PRGF, Stand-By, and Emergency Assistance

41. **This option would leave the PRGF unchanged, replace the ESF with a concessional Stand-By-like instrument, and create a unified concessional facility for emergency situations.** As a first pillar, the PRGF would be available to countries facing medium- and longer-term adjustment needs. The second pillar would be a concessional short-term financing facility (similar to the SBA for GRA users) that could cover all short-term balance of payments needs, including those resulting from shocks and policy slippages.[31] This facility could be used on a precautionary basis, and would not require a PRSP. To limit overlap with the PRGF and discourage repeated use in lieu of the PRGF, the facility would be intended, like the PSI, only for countries not facing a medium- or longer-term adjustment need, although it could occasionally serve as a short-term bridge to a PRGF in the event of an urgent need. The third pillar would be a concessional emergency facility that could provide rapid/low-access support with limited conditionality in instances where policies do not meet UCT standards and LICs currently turn to ENDA, EPCA, and the ESF-RAC, while also allowing access for needs in other fragile situations.[32]

- **Pros**: The proposal would tailor facilities to the main types of adjustment need. It would maintain the PRGF's recognized and successful role as a medium-term facility to support medium- and longer-term adjustment needs and HIPC debt relief. The Fund would have a flexible short-term instrument that would address a range of balance of payments needs, avoiding the need for difficult judgments over the relative weight of exogenous and endogenous factors seen in recent ESF cases, and would be well-suited for countries that no longer face entrenched macroeconomic imbalances. The unified emergency facility would provide a highly flexible tool for all forms of emergencies, when speed is often critical. The three-pillar structure would be logically aligned with key GRA instruments (EFF, SBA, and EPCA/ENDA), facilitating blending. The new short-term facility could be created relatively easily by broadening the eligibility criteria of the ESF-HAC to the general balance of payments needs criterion used for an SBA.

[31] A variant would be to subsidize interest on the SBA. As noted in Section V.B, shorter repayment periods could be considered for short-term adjustment lending, but this would significantly reduce concessionality and possibly aggravate debt vulnerabilities. A standard SBA would also introduce quarterly monitoring, which is rarely needed or practical in LICs. And as discussed in Section VII, the Executive Board has in the past preferred to have dedicated facilities for LICs.

[32] The emergency facility could have a rapid access component, with outright purchases and no (ex-post) conditionality, for temporary shocks such as natural disasters. Access limits could be set at a uniform level or differentiated by the nature of the emergency. While the former would be preferable for simplicity, it may be useful to allow higher access in case of natural disasters and post-conflict situations in line with existing limits.

- **Cons**: Countries with entrenched balance of payments problems could seek repeated short-term arrangements that do not fully address underlying adjustment needs. Establishing shorter (Stand-By-like) repayment terms and/or a presumption that the short-term facility is intended for countries that do not face medium- or longer-term balance of payments needs (or, if needed, as a bridge toward a PRGF) could be helpful, although the former may create debt service pressures and the latter would still require some degree of judgment. The short-term financing facility would be a step away from the PRSP-based poverty reduction and growth framework underlying the PRGF and may raise questions about the Fund's policy focus in countries that are still poor and aid-dependent. The possibility of considerable demand for the Stand-By-like facility could require additional concessional resources (see Section VI).

Option 3: Single Concessional Financing Facility

42. **This option would replace all existing facilities with a single concessional instrument with flexible length.** The facility could provide three-year financing to assist countries with prolonged adjustment needs. It could also provide shorter-term financing for shocks and policy slippages. PRSP requirements could apply from the second or third year of financing. The facility could be used on a precautionary basis. Countries with programs not meeting UCT standards could receive short-term financing through outright purchases of up to 25 percent of quota for all emergency situations. As a transitional arrangement, the PRGF would be kept active for all existing arrangements and pre-HIPC completion point countries.[33]

- **Pros**: The single facility would go furthest on streamlining. It would be simple and flexible in that there would be no ambiguity or arbitrage between facilities, and countries could move between shorter and more medium-term arrangements based on circumstances. It would focus IMF lending on temporary balance of payments support to smooth adjustment toward a sustainable macroeconomic position. It would also limit differences in access, qualification standards, and concessionality that exist with multiple facilities.

- **Cons**: This radical departure from the current LIC facilities architecture could create significant uncertainty about the Fund's financing role and objectives in LICs. The lack of facility differentiation runs four risks: (i) stigma perceived by relatively advanced LICs; (ii) applying uniform design features (e.g., conditionality, PRSP, and

[33] A possible variant of this option would be a single policy support facility with flexible length, with financing determined annually based on needs (which could be zero). This variant would allow medium-term policy support that matches financing more closely to annual balance of payments needs, similar to the ESAF. The policy support element could be offered as a technical service under Article V, similar to the PSI, while annual financing arrangements could run in parallel.

access policies) to highly diverse country circumstances; (iii) difficulties in funding an undifferentiated facility since some donors have preferred earmarking in the past; and (iv) lack of clarity as to whether a three-year arrangement would have the same growth and poverty objectives as a PRGF arrangement. While the first two concerns could be alleviated by differentiating program design for different users, this would add back much of the complexity of multiple facilities.

Table 2. Characteristics of Alternative LIC Facilities Architectures

	Status Quo: PRGF, ESF EPCA, ENDA	**Model 1: More Flexible PRGF and EPCA**	**Model 2: PRGF, LIC-SBA, Emergency Assistance**	**Model 3: Single Financing Facility**
Gaps	Lacks flexible short-term, precautionary, and emergency financing.	No major gaps.	No major gaps.	No major gaps.
Overlaps	Multiple shocks and emergency facilities.	Multiple shocks and emergency facilities.	No major overlaps.	No major overlaps.
Streamlining	Multiple, asymmetric facilities.	All programs with policy content consolidated under PRGF.	Emergency financing consolidated.	Single facility for all needs.
Tailoring	Medium-term adjustment, shocks, certain emergencies	PRGF windows tailored, but blurs role of PRGF.	Each facility tailored to one main adjustment need.	Some tailoring by length of program, but weak differentiation signal.
Flexibility	No flexible instruments.	Flexible length PRGF, with precautionary option, and flexible EPCA.	Flexible short-term and and emergency facilities.	Flexible length, and precautionary option.
PRSP	PRGF requires PRSP upfront, ESF not.	PRSP for both short- and medium-term financing.	PRSP for PRGF, not for short-term financing.	PRSP only for medium-term financing.
GRA Symmetry	No equivalent of SBA and precautionary SBA.	No equivalent of SBA.	SBA & EFF-like facilities, but emergency assistance not fully aligned.	No EFF-like instrument, and emergency assistance not fully aligned.

V. Facility Design

A. Access

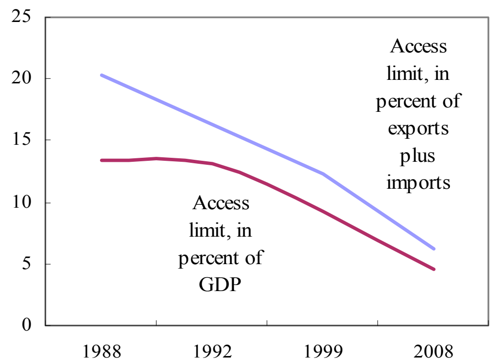
43. **Access limits play an important role in allocating scarce concessional resources across LIC members.** As shown in Table 1, access limits differ across the various concessional or subsidized instruments (PRGF, ESF, ENDA, and EPCA). For the PRGF, access is also subject to norms, which were introduced in 2004 to provide general guidance for access decisions in cases of repeated PRGF use. In light of the evolving financing needs of LICs and possible changes to lending policies and facilities discussed above, it is useful to reassess the appropriateness of the current access policies, bearing in mind possible implications for the concessional resource envelope.

44. **PRGF access limits have declined significantly in effective terms since the inception of the ESAF in 1987** (Figure 11 and Table 3).[34] The decline partly reflects the

[34] These figures exclude China and India. In addition, Afghanistan, Liberia, and Somalia were not included initially and in some subsequent calculations owing to the lack of reliable GDP data.

downward revision of the maximum access limit and partly the more rapid GDP and trade growth of eligible countries relative to quota increases.[35] Moreover, when the proposed increases in both the annual and cumulative limits on GRA access become effective,[36] the difference between PRGF and GRA access limits will widen sharply. While some differential in access limits is generally justified by differences in debt management capacity and exposure to capital account volatility, LICs have become increasingly integrated into the world economy and susceptible to capital account shocks.

Figure 11. Access limits have declined substantially as shares of GDP and trade.



Sources: International Monetary Fund; WEO, IFS, FIN Databases; and IMF staff estimates.

Table 3. Access Limits
(In percent of quota)

	1988 1/	Current limit	Proposed limit
GRA			
Annual access	110	100	200
Cumulative access	440	300	500
PRGF 2/			
Maximum access	250	140	…
Exceptional access	350	185	…

Source: Finance department.

1/ A system of dual limits was in place for GRA access during this period. The table shows the upper limit.
2/ There are no annual or cumulative access limits on the use of PRGF resources.

45. **Access limits are likely to become increasingly binding; there have already been a few examples of access at or above the limit** (Figure 12). In addition to the erosion of access in relation to GDP and trade, the economic circumstances of PRGF-eligible members have changed considerably in recent years (as described in Section III.C) in ways that could increase their need for Fund support. Recent cases of access at or above the limit include: augmentation to maximum PRGF access for Haiti; access at the ESF limit for the Kyrgyz Republic and Malawi; use of SBAs with access above PRGF limits by Georgia and Pakistan; and exceptional maximum PRGF access for Liberia's arrears clearance. Further cases are expected in the near future.[37]

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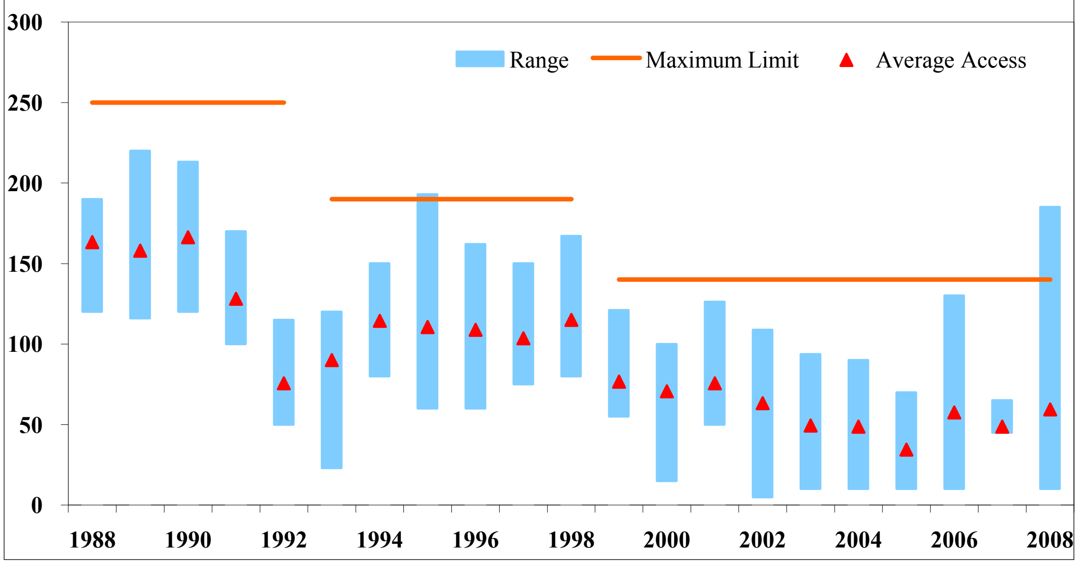
[35] The initial maximum and exceptional limits on access were set at 250 and 350 percent of quota, respectively. The determination of the maximum limit was based on projections of members' financing needs and the amount of resources available. The limits have been reduced twice in the context of the 9th and 11th quota reviews.

[36] *Review of Access to Financing in the Credit Tranches and Under the Extended Fund Facility, and Overall Access Limits Under the General Resources Account.*

[37] The survey of mission chiefs (see forthcoming Supplement) indicates that PRGF access norms (together with balance of payments needs) have been important in determining access. For a non-negligible minority, access limits have been the main determining factor. Mission chiefs considered that in more than half of program countries access norms and limits either had already become too restrictive or could become restrictive in the next three years.

46. **The current global economic crisis is likely to result in large-scale balance of payments financing needs for several LICs.** As shown in the staff paper on the impact of the global crisis, 22 LICs are particularly vulnerable to the crisis. Over the medium term, based on updated WEO projections, annual financing requirements of LICs could exceed US$110 billion, as compared to US$25 billion at the inception of the ESAF.

Figure 12. Access Levels Under PRGF Arrangements
(In percent of quota at the time of Board approval)



47. **These factors argue in favor of increasing access limits for the Fund's concessional facilities.** Higher access limits would allow for more meaningful Fund support to LICs in cases of large needs and would reduce the risk that LICs resort to non-concessional support, which may create debt service problems in the future. One possible approach would be to restore access limits to their 1998 levels relative to key macroeconomic indicators such as GDP and trade. This would be consistent with the approach taken in *Review of Access to Financing in the Credit Tranches and Under the Extended Fund Facility, and overall Access Limits Under the General Resources Account* to determine new access limits for GRA resources based on access levels at the time quotas were last raised in the context of the 11th General Quota Review. Preliminary calculations suggest that the maximum PRGF access limit would have to more than double to restore it to its 1998 level relative to GDP.

48. **In determining the appropriate scale of a possible increase in access limits, it will be important to balance potential financing needs against resource constraints and other relevant factors.** Higher access limits would likely boost demand for the Fund's concessional resources and, as discussed in Sections VI and VII, resource constraints are more pressing in the case of the Fund's concessional resources than for the GRA. Moreover, Fund concessional financing plays a central role in catalyzing donor support, and it will be important to maintain the incentives for LICs to seek financing from donors on more

concessional terms. A sharp increase in access limits could also imply a substantially higher medium-term debt service burden for some countries.

49. **On balance, the urgency of financing needs in the context of the global crisis would argue for some upfront interim increase in access limits alongside efforts to secure the necessary additional subsidy resources.** To ensure that concessional resources are used efficiently, it would be important to clarify the use of blended arrangements and to review PRGF eligibility on a regular basis (Section V.B). Judgment will remain important in determining access levels in individual cases, and particular attention will need to be paid to debt service costs, especially in countries whose quotas are relatively high in economic terms.

50. **PRGF access norms (Table 4) have been applied flexibly, but modifications could be considered, particularly if PRGF access limits are raised.** The norms were designed to provide general guidance for access decisions in cases of repeated PRGF use, not hard-and-fast ceilings (or floors) on access for specific arrangements.[38] About one third of new PRGF arrangements approved since 2004 have exceeded the norms, and some upward revision may be warranted.

Table 4. PRGF Access Norms
(In percent of quota)

Arrangement	Norm
First time	90
Second time	65
Third time	55
Fourth time	45
Fifth time	35
Sixth time	25

Source: Finance department

51. **In the second stage of the review, staff will develop specific proposals on access limits and rules, alongside reforms of facilities and the financing framework.** In the event of an increase in PRGF access limits, PRGF access norms could be increased proportionally. In addition, consideration would need to be given to access rules for the ESF, emergency assistance, and any new LIC facilities, depending on the overall architecture agreed. Any changes should aim to ensure consistency of access rules across facilities to limit incentives for arbitrage and reduce the risk that LICs turn to the GRA for financing, with shorter maturities and higher interest rates, which could create future debt service problems.

B. Financing Terms

52. **The grant element of PRGF/ESF loans has declined as a result of low global interest rates, but there are good arguments for maintaining the existing financing terms.** As the interest rate on PRGF/ESF loans is only ½ percent, reducing it further to zero

[38] Decisions on access typically take into account a combination of factors: (i) balance of payments needs; (ii) the strength of the program and the degree of the adjustment effort; (iii) outstanding concessional credit and record of use of such credit in the past; and (iv) ability to repay the Fund. In some cases access far above the norm was provided, for instance in Haiti and Togo (140 and 115 percent of quota versus norms of 65 and 55 percent of quota respectively).

would have little effect on concessionality.[39] Alternatively, extending maturity beyond ten years to achieve greater concessionality would raise questions about the temporary nature of PRGF-ESF Trust Fund lending and, more generally, the nature of Fund assistance to LICs, which, as discussed in Section III.B, is primarily aimed at intertemporal adjustment smoothing as opposed to development-type resource transfers. In addition, IMF financial support with UCT standard programs plays a unique role in catalyzing (more concessional) donor flows. Finally, relaxation of PRGF/ESF loan terms would place greater demands on the Fund's subsidy resources; in this trade-off, providing adequate access to meet urgent needs is likely to be more important than concessionality, given the Fund's unique role.

53. **The Fund could, however, consider whether shorter repayment periods would be appropriate for short-term adjustment lending.** Such an approach could discourage use (including repeated use) of a short-term facility when longer-term adjustment is needed, and place less of a burden on limited concessional resources as loan resources would be repaid sooner and fewer subsidy resources would be needed. However, shorter repayment periods would further reduce the concessionality of Fund assistance and add to near-term debt service burdens. In addition, given the lower grant element and shorter maturity, countries with short-term needs might seek longer-term instruments, thereby tying up concessional resources for longer. On balance, uniform PRGF/ESF terms across LIC instruments would seem preferable. And to the extent that a shorter repayment period might be appropriate for some more advanced LICs, this could be achieved through blending with GRA instruments.

54. **Similarly, introducing more flexible repayment terms, while potentially useful for development lending, is less appropriate for the Fund.** Several agencies are considering innovative financing terms, including an approach piloted by the *Agence Française de Développement*, which provides for a flexible grace period to reduce debt service in times of shocks. This makes debt service in effect counter-cyclical, which could help limit the risk of debt problems. For the Fund, implementing such approaches would be less effective, given the PRGF-ESF Trust's relatively short grace and repayment periods, and the already counter-cyclical nature of Fund disbursements. Moreover, flexible repayment terms require a simple shock definition (e.g., a sharp drop in export prices), while Fund financing should generally take into account all factors causing balance of payments needs. Another option would be to make members aware that PRGF credit can be repaid early in the

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[39] The grace period and maturity of PRGF/ESF loans are 5½ and 10 years, respectively, and the interest rate is 0.5 percent per annum. At the inception of the ESAF in 1987, concessionality of the Fund's concessional loans was estimated at about 48 percent, although the methodology for calculating grant elements has evolved since then. In recent years, as market interest rates have fallen to low levels, PRGF concessionality has declined and is currently estimated at 28 percent; a reduction to an interest rate of zero would raise the grant element to 31 percent. For comparison, IDA loans have a 0.75 percent annual interest rate, with a grace period and maturity of 10 and 40 years respectively. From the recipient's point of view, the grant element is often higher than conventionally measured as domestic interest rates exceed world interest rates in most LICs by wide margins.

event that balance of payments needs decrease unexpectedly, which could help preserve concessional resources. However, given the low interest rate, it is unlikely that this option would be exercised frequently. On balance, for the Fund, the operational complexity of more flexible repayment terms appears to outweigh the potential benefits.

55. **At the same time, there is a strong case for increasing the concessionality of emergency assistance to LICs by extending it on the same terms as PRGF/ESF loans.** Currently, ENDA/EPCA credit is less concessional than PRGF/ESF loans, since repurchases are made on GRA terms, with a shorter grace period (3¼ years) and maturity (5 years) than PRGF/ESF loans. Resources permitting, the rate of charge on ENDA/EPCA credit is subsidized to 0.5 percent per annum through donor contributions. Given debt-related vulnerabilities of many low-income countries, it would be appropriate to finance both the principal and the interest subsidies for ENDA/EPCA through the PRGF-ESF Trust, which would make concessionality symmetric across all LIC facilities. It would, however, require an amendment to the PRGF-ESF Trust Instrument and consents by all lenders and subsidy contributors.

56. **There may also be merit in revisiting the application of rules for blending concessional financing with GRA resources.** In 2004, the guidelines on blend arrangements were clarified and strengthened.[40] The guidelines have been implemented flexibly, as envisaged. Since 2004, the Board has approved two "blend" arrangements under the PRGF and EFF—one with Albania in 2006 (given its relatively high per capita income level) and the other with Liberia in 2008 (necessitated by a large arrears clearance operation). Over the same period, several countries meeting the criteria for blend arrangements have opted for GRA financing only (Pakistan, Georgia, and Honduras) or PRGF financing only (Armenia, Djibouti, and Grenada). The guidelines could be strengthened further by (i) recommending blended arrangements only for countries that meet minimum standards of debt sustainability in the context of debt sustainability analyses (DSAs); (ii) clarifying the approach in exceptional cases where countries do not meet the criteria for blending, but require access above the relevant concessional (PRGF and ESF) thresholds, such as for arrears clearance operations; and (iii) establishing a blending mechanism that applies consistently across facilities.

57. **To safeguard concessional resources, eligibility for concessional financing could be reviewed more regularly.** PRGF eligibility is occasionally reviewed by the Fund's

[40] Under these guidelines, there is a presumption that a blended arrangement would be considered if either (i) a member's per capita income exceeds 75 percent of the prevailing IDA operational cutoff, or (ii) a member had significant recent or prospective nonconcessional borrowing from private capital markets or the "hard" windows of official bilateral and multilateral lenders. If neither condition is met, there is a presumption of concessional financing only. Access to concessional resources in a blend arrangement was expected to be one half of the PRGF norms (in percent of quota). Access to GRA resources is guided by GRA access policies.

Executive Board based on the prevailing International Development Association (IDA) and IDA-blend eligibility. There are currently several PRGF-eligible countries above the IDA operational cutoff (a 2007 per capita income of $1,095) that remain eligible for IDA or IDA-blend financing, reflecting considerations of creditworthiness and exceptions for small islands. It may be useful to review PRGF eligibility and relevant criteria in the near future, possibly followed by regular reviews on a fixed cycle.

C. Assessment of Balance of Payments Need

58. **In recognition of LICs' longer-term adjustment needs, PRGF financing has been provided to countries facing a "protracted balance of payments problem."** This implies an eventual balance of payments need over the course of the three-year arrangement, and not necessarily a present need at the time of approval of the arrangement or a subsequent disbursement (see *Need as a Condition for the Use of Fund Resources*. As in the GRA context, the assessment of the size of need requires some degree of judgment, in part because needs are endogenous to economic policy choices. This judgment can be especially complex in LICs that face entrenched structural problems and a long adjustment process, as imbalances often manifest themselves in output gaps and import compression (partly due to lack of market access), rather than low reserves or large balance of payments deficits. Similarly, phasing half-yearly disbursements to match balance of payments needs can be particularly difficult in the context of entrenched balance of payments problems. In recognition of these factors, access is usually anchored in the medium-term PRSP-based macroeconomic framework, and the protracted balance of payments problem standard enables the Fund to provide support in a predictable manner.[41]

59. **While the PRGF's protracted balance of payments problem standard remains relevant for medium- and longer-term adjustment lending, short-term financing instruments are more appropriately based on present needs.** As discussed in Section III, a majority of LICs continue to face entrenched macroeconomic imbalances and structural challenges, and the protracted needs standard remains appropriate in these circumstances. However, for the increasing number of LICs that no longer face longer-term adjustment challenges and require only short-term financial support, it is generally not appropriate to apply the protracted needs standard. Accordingly, the ESF, for instance, is based on present needs, which would also be appropriate for potential new short-term facilities discussed in Section IV.

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[41] One drawback of committing PRGF financing based on a protracted balance of payments problem standard is that it ties up scarce concessional resources for three years irrespective of eventual needs since the disbursement schedule is usually not revised down in the event that needs are lower in the outer years. It has also been argued that the standard is inconsistent with treating the PRGF as precautionary.

D. Conditionality

60. **In recent years, the Fund has made efforts to streamline conditionality.** Conditionality in Fund-supported programs is designed to ensure that appropriate measures are taken to resolve a country's balance of payments problem and enable it to repay the Fund, while giving the member assurances about steps needed to secure financing. Structural conditionality is often particularly controversial, with questions about whether it is (i) sufficiently mindful of political, institutional, and capacity constraints, (ii) well-designed and "macro-critical," and (iii) appropriately focused on areas of Fund expertise. Since 2002, the Fund has been promoting the principles of "parsimony" and "criticality" in the design of structural conditionality. The 2007 IEO study found that some progress has been made in making conditionality more focused.

61. **A possible reform of the Fund's LIC facilities architecture presents an opportunity to clarify how conditionality should be tailored to country circumstances and facilities.** Conditionality should reflect the diversity of LICs, with different capacities and adjustment needs. Countries in post-conflict or fragile situations would be expected to have fewer structural conditions, with measures targeted at building basic institutions and mechanisms to enable the government to conduct macroeconomic policies. Conditionality for countries undergoing a longer-term adjustment process would typically have higher structural content, derived from country-owned PRSPs. By contrast, countries that are moving to emerging market status would typically have a limited number of "second-generation" reform benchmarks, for instance related to capital market integration and financial sector stability (these reforms could still be drawn from country-owned PRSPs). While short-term adjustment programs might have more limited conditionality, it could be more important to undertake measures quickly, whereas longer-term adjustment programs might allow for greater flexibility on the timing of reforms.

62. **The second stage of the review will consider options for making conditionality for LICs more flexible, including by applying changes proposed in the GRA context.** The broader conditionality paper[42] proposes three options for reform relevant to LICs: (i) a move toward review-based conditionality which would involve the elimination of performance criteria in favor of assessments of program implementation based on a set of quantitative and structural targets, where an individual breach would not in itself interrupt purchases under the program or trigger the need for a waiver; (ii) greater use of ex-ante conditionality (as in the Short-Term Liquidity Facility), although this would be less appropriate in arrangements of longer duration; and (iii) a hybrid of the two approaches. For LICs, the shift toward review-based conditionality might be particularly useful for members with a medium-term structural reform agenda where there is uncertainty surrounding the timing of particular reforms and where some flexibility might be desirable.

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[42] *Conditionality in Fund-Supported Programs—Purposes, Modalities and Options for Reform.*

VI. Concessional Resource Envelope and Projected Financing Needs

63. **In light of the global financial crisis, demand for the Fund's concessional financing is likely to increase significantly in both the short and medium term.** Depending on the severity of the crisis, demand could exceed the concessional resources currently available. In addition, possible modifications to access policies and LIC facilities discussed above could imply additional financing needs. This section reviews resource availability and discusses possible financing requirements. Reflecting Executive Directors' views on potential access and facilities changes, staff will prepare updated projections of potential demand in a follow-up paper.

A. Resource Availability

64. **At end-2008, available loan and subsidy resources for PRGF/ESF lending amounted to SDR 2.5 billion and SDR 1.3 billion, respectively.** These resources include actual balances held in the PRGF-ESF Trust and contributions that have been committed but not yet received. Of the available subsidy resources, it is estimated that SDR 0.3 billion would be needed to cover existing PRGF/ESF credit. This would leave a balance of about SDR 1 billion that could subsidize new PRGF/ESF loans of about SDR 4.5 billion (though additional loan resources of SDR 2 billion would be needed to fully utilize available subsidy resources). As explained in Box 1, compared with the estimates provided in the last update paper *Update on the Financing of the Fund's Concessional Assistance and Debt Relief to Low-Income Member Countries* , the recent sharp decline in SDR interest rates has reduced estimated subsidy needs for existing PRGF/ESF credit and new loans, thus allowing available resources to subsidize a higher projected level of new lending.

65. **Available resources in the PRGF-ESF Trust include resources committed in the context of the original ESF fund-raising exercise.** At the establishment of the ESF in 2005, the initial target was to secure financing sufficient to cover the projected demand for ESF loans of SDR 2 billion and subsidy resources of SDR 0.5 billion for a five-year period.[43] To date, 11 countries have pledged subsidy contributions of SDR 0.2 billion and new loan resources of SDR 0.6 billion.

66. **It has long been envisaged that, once the available resources in the PRGF-ESF Trust are depleted, new PRGF/ESF lending could be subsidized by the resources available in the PRGF-ESF Reserve Account on a "self-sustained" basis.** The Reserve Account is designed to provide security to lenders in the event of a delay or nonpayment by borrowers, meet temporary mismatches between repayments from borrowers and payments

[43] See *Proposed Reforms to the Exogenous Shocks Facility—Background Information on Financing of PRGF-ESF Operations*.

to lenders, and cover the Fund's costs of administering PRGF-ESF operations.[44] In the context of the MDRI discussions in 2005, most Executive Directors supported an approach that would require bilateral lenders to continue providing loan resources to finance the Fund's concessional lending operations, while the income earned on the balances in the Reserve Account would be used to finance interest subsidies. This approach would require an amendment of the PRGF-ESF Trust Instrument with an 85 percent majority of the total voting power and consents of all current PRGF-ESF Trust lenders.

[44] The Reserve Account has been financed by reflows of SAF and Trust Fund repayments, which were originally financed by the proceeds from gold sales in the 1970s. As of end-2008, the Reserve Account held a balance of SDR 3.8 billion.

Box 1. Impact of the Decline in SDR Interest Rates on Subsidy Resources

The projected subsidy resource availability hinges on the future path of SDR interest rates. Since the last update paper *Update on the Financing of the Fund's Concessional Assistance and Debt Relief to Low-Income Member Countries* , SDR interest rates have fallen to new lows, which will have important implications for future concessional lending.

Previous projections

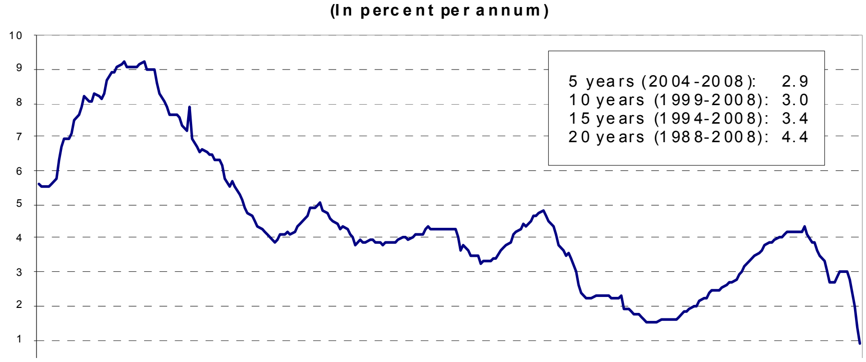
In *Update on the Financing of the Fund's Concessional Assistance and Debt Relief to Low-Income Member Countries*, staff assumed that the average annual SDR interest rate would rise gradually from 4 percent in 2008 to 5 percent by 2013 and remain at that level thereafter. Based on this assumption, it was estimated that available PRGF-ESF subsidy resources would be sufficient to subsidize new lending of SDR 3.2 billion and the Reserve Account could sustain an annual subsidization capacity of SDR 0.8 billion. It was also estimated that subsidy resources available for ENDA/EPCA credit could be depleted by end-2009.

Updated projections

Reflecting recent market developments, staff has updated assumptions and projections. It is now assumed that SDR interest rates will remain below 1 percent in 2009 and rise gradually to 4.5 percent by 2014 and thereafter. The revised assumption on long-term SDR interest rates aligns more closely with the historical average. On this basis, available PRGF/ESF subsidy resources could subsidize new lending of about SDR 4.5 billion. The lower interest rates would reduce subsidy needs of existing PRGF-ESF credit and new loans, and available subsidy resources would last longer.

At the same time, the lower interest rates would reduce investment income on the Reserve Account balance and decrease the estimated "self-sustained" subsidization capacity. It is now estimated that the Reserve Account could subsidize PRGF/ESF loans of about SDR 0.7 billion per year. With lower interest rates, subsidy needs for ENDA/EPCA are also lower, and resources currently available are estimated to be broadly sufficient for existing credit. However, additional resources would be needed to meet new ENDA/EPCA requests.

SDR Interest Rates, 1988-2008
(In percent per annum)



67. **Based on staff's updated projections, the resources in the PRGF-ESF Reserve Account could subsidize annual PRGF/ESF loans of about SDR 0.7 billion on a self-sustained basis (Box 1).** These projections are based on the assumption that currently available subsidy resources are sufficient to cover the potential demand through 2010 and that the "self-sustained" operation would be initiated in 2011. They are also subject to several other important assumptions regarding the rate of investment earned on the Reserve Account balances and interest rate paid to Trust lenders, the resumption of reimbursement of the GRA

for PRGF-ESF administrative expenses, and repayments of overdue Trust Fund, SAF, and PRGF obligations by the protracted arrears cases.[45]

B. Projected Financing Needs

Short-term prospects

68. **The global economic crisis is likely to lead to a substantial increase in balance of payments needs of LICs.** As discussed in the staff paper on the impact of the global crisis, it is expected that many LICs will face a significant deterioration of external positions due to collapsing commodity prices and anticipated adverse effects on exports, remittances, and capital inflows. Among PRGF-eligible countries, 22 are considered particularly vulnerable to the current global crisis due to their relatively close linkages with the rest of the world.

69. **Near-term demand for concessional financing could more than double as a result of the global financial crisis.** Based on country-specific information provided by area departments, several countries are expected to request new PRGF/ESF arrangements in 2009-10 and many of those with PRGF/ESF arrangements currently in place may request augmentations. It is estimated that demand for concessional financing could increase from SDR 0.8 billion in 2008 to an annual average of SDR 1.3–2 billion in 2009-10 (Table 5).[46] Given the uncertainties associated with the current global environment, these projections are highly tentative and should be treated as illustrative.

- **Scenario 1:** Assuming that half of the current PRGF/ESF users request augmentations of 15 percent of quota (the average size of the augmentations in 2008) and all countries that are expected to seek new PRGF/ESF arrangements request access in line with norms, annual lending could average SDR 1.3 billion in 2009-10.

- **Scenario 2**: In the event of a more severe impact of the global crisis, demand could average SDR 2 billion a year for 2009-10. This assumes that countries that have PRGF/ESF arrangements in place and are considered highly vulnerable request augmentations of 30 percent of quota (while the rest of current users request augmentations of 15 percent of quota), and that the remainder of highly vulnerable countries seek new PRGF/ESF arrangements with access of 20 percent of quota above the norms (while other countries request new arrangements at normal access).

[45] For a more detailed discussion of key assumptions underlying the estimated subsidization capacity of the PRGF-ESF Reserve Account, see *Estimates of PRGF-ESF Reserve Account Subsidization Capacity Under Different Assumptions*.

[46] These projections do not take into account possible financing requirements for the three protracted arrears cases (Somalia, Sudan, and Zimbabwe).

Table 5. Demand for PRGF/ESF Resources Under Different Scenarios, 2009-10
(In billions of SDRs)

	Number of requests	Scenario 1	Scenario 2
A. Expected requests for augmentation under current PRGF/ESF arrangements	22	**0.2**	**0.5**
Highly vulnerable countries 1/	7	0.1	0.3
Others	15	0.1	0.2
B. Expected requests for new PRGF/ESF arrangements	34	**2.5**	**3.6**
Highly vulnerable countries 1/	18	1.6	2.6
Others	16	0.9	1.0
Total	**56**	**2.7**	**4.0**

Source: Staff estimates.

1/ The list of countries identified as highly vulnerable to the current global crisis is provided in the forthcoming Board paper on *The Implications of the Global Financial Crisis for Low-Income Countries*. However, several of the countries identified as highly vulnerable are not expected to request concessional resources either because they have arrears to the Fund or they are expected to request assistance from the GRA.

70. **Regarding emergency assistance, due to lower SDR interest rates and subsidy needs, resources available are now estimated to be broadly sufficient to cover existing ENDA/EPCA credit (Box 1).** While projections for new demand are inherently difficult for this type of lending, additional resources would need to be identified to meet new requests in a timely manner. In March 2008, the Managing Director requested additional contributions to address the subsidy needs of ENDA/EPCA, estimated at SDR 100 million, to cover existing ENDA/EPCA credit and new lending through 2014.[47]

Medium-term prospects

71. **Over the medium term, demand for the Fund's concessional financing is likely to remain above historical levels.** This reflects: (i) increasing exposure to volatility of global growth and commodity prices, higher exposure to private sector financing, and increasing likelihood of emerging market-type stress periods in a few LICs, with greater co-movement of LIC financing needs and global capital market conditions (see Section III.C); (ii) the risk of a protracted fallout from the global financial crisis; and (iii) potential financing requests by the three protracted arrears cases following clearance of arrears to the Fund.

72. **Annual demand for the Fund's concessional assistance could range from SDR 1 billion to SDR 2 billion over the medium term.** These projections are based on the estimated share of the Fund's concessional financing, excluding HIPC/MDRI debt relief, in

[47]In response, several countries have responded positively, with two committing to a specific amount, while others have declined or need more time to consider.

total gross financing requirements (GFR) of PRGF-eligible countries (Table 6).[48] The Fund's share has declined from an average of about 4¼ percent in 1988-02 to 1¼ percent in 2003-08, reflecting LICs' improved performance, access to other sources of financing, debt relief, and declining access norms for repeated PRGF use. Using available WEO projections and assuming that the Fund's share in the GFR remains at the recent level, annual demand for the Fund's concessional financing would amount to about SDR 1 billion. If, however, the factors discussed above result in a rise of the Fund's share in the projected GFRs to its long-run average of 2.9 percent, annual demand would rise to SDR 2 billion per year.

Table 6. Gross Financing Requirements and the Fund's Concessional Assistance
(In billions, annual average; unless otherwise noted)

	Gross financing requirements (GFR) 1/ 2/		IMF concessional assistance (excluding debt relief)	
	(US$)	(SDR)	(SDR)	(Percent of GFR)
	A	B	C	D=C/B
1988-1992	24.7	18.4	0.7	3.6
1993-1997	38.3	26.8	1.2	4.6
1998-2002	39.1	29.6	1.3	4.3
2003-2008	76.1	50.7	0.6	1.2
1988-2008	46.1	32.3	0.9	**2.9**
Memo:				
2009-2013 3/	110.7	70.3		

Source: WEO and staff estimates.

1/ GFR is defined as the current account deficit excluding official transfers, amortization payments, change in arrears and change in reserves.
2/ Excludes India, Somalia, Sudan.
3/ Based on current WEO projection.

73. **Additional resources would thus likely be needed to meet LICs' medium-term concessional financing needs, which are expected to be around twice the 2008 level.** The required amount of additional resources would also depend on the potential financing needs that could arise from changes in access limits and LIC lending facilities discussed above. Under a central projection of annual demand for concessional assistance averaging about SDR 1.5 billion, an additional SDR 0.7 billion in subsidy resources would be needed to supplement the lending capacity of the Reserve Account through 2015. To cover demand over the same period, new loan resources of SDR 9 billion would also need to be secured.

[48] The GFR is defined as current account deficits excluding official transfers, amortization payments, and changes in arrears and reserves. This approach was used as the basis for projecting demand for PRGF resources in 1999 and 2003. See *The Fund's Support of Low-Income Member Countries—Considerations on Instruments and Financing*.

VII. Concessional Financing Framework: Issues and Options for Reform

74. **The review of LIC facilities, with possible changes to lending policies and instruments, presents an opportunity to revisit the Fund's concessional financing framework.** Reforming the LIC facility architecture, as discussed in Section IV.C, would likely require amendments to the PRGF-ESF Trust Instrument, and it is therefore useful to also consider whether changes to the Fund's concessional financing arrangements would be desirable. In its April 2008 Communiqué, the IMFC called on the Fund to provide for a structured way of approaching donors regarding funding requests and encouraged members to provide additional financial contributions to ensure that the Fund can continue to subsidize emergency assistance and capacity building to its low-income members. Support for a review of the Fund's concessional financing arrangements was also expressed at the informal Board briefing on May 14 and the Oslo donors meeting on May 15, 2008.

75. **This section reviews the Fund's existing concessional financing arrangements and discusses possible options for reform**. Any reform should help ensure that the Fund has sufficient concessional resources to meet LICs' evolving financing needs and address potential changes in lending facilities. Reflecting the views of Executive Directors, staff will prepare follow-up papers to lay out specific modalities on these proposals.

A. Existing Financing Arrangements

76. **The structure of the Fund's concessional financing framework has become increasingly complex over time.** As shown in Figure 13, financing of the Fund's concessional lending has mostly been channeled through various trusts and administered accounts, separate from the Fund's GRA operations.[49] In its fund-raising efforts, the Fund has sought to accommodate donor preferences for earmarking their contributions for particular purposes. The concessional financing framework has evolved in stages:

- During the mid-1970s and early 1980s, loans at subsidized interest rates were financed from the sale of part of the Fund's gold holdings and made through the Trust Fund, and later, under the SAF.

- At the inception of the ESAF in 1987, the IMF's Board decided that a trust arrangement for concessional lending would be most appropriate and that both loan and (most) subsidy resources would be provided by bilateral contributors. Most of the reflows from the Trust Fund and the SAF were placed in the Reserve Account, which provides security to bilateral lenders.

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[49] Reasons for funding the Fund's concessional operations outside the GRA have included: (i) safeguarding the use of the Fund's general resources as liquid reserves of the Fund's creditors; (ii) limiting credit risk for the GRA; and (iii) allowing, in the case of the PRGF, a more flexible standard of balance of payments need.

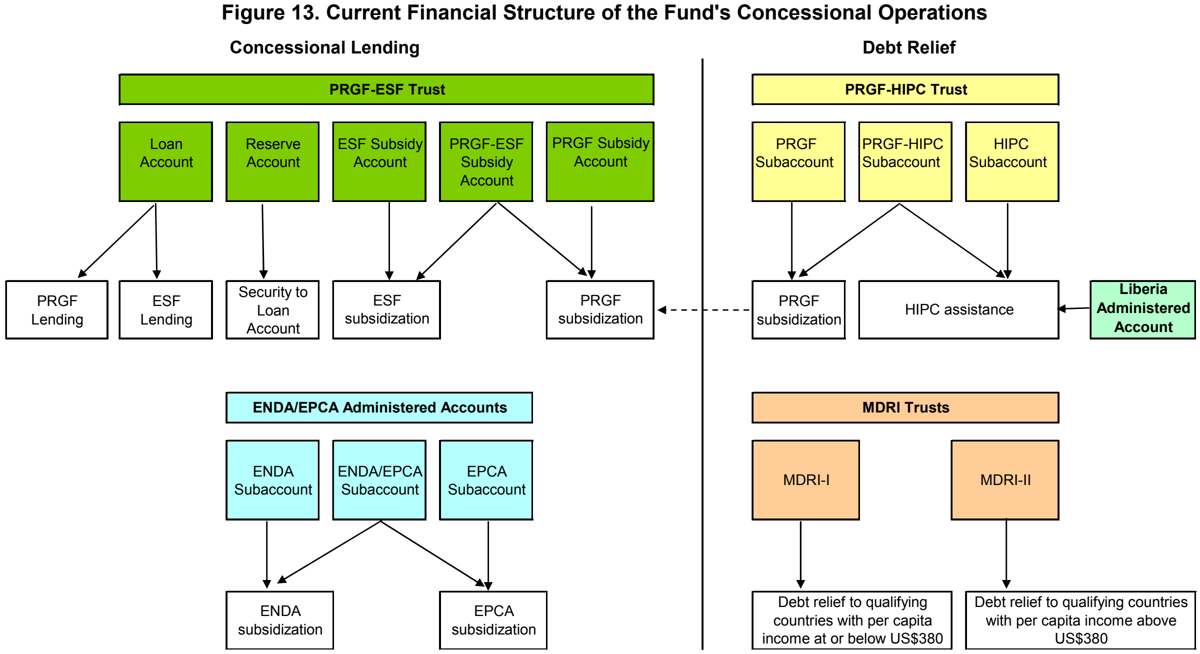
- In the context of the enhanced HIPC Initiative in 1999, the ESAF was transformed into the PRGF, with a focus on promoting growth and reducing poverty. Additional contributions for HIPC debt relief were mobilized and channeled through the separate PRGF-HIPC Trust.

- When the ESF was set up in 2005, the purposes of the PRGF Trust were expanded and the Loan Account was extended to cover the principal of ESF lending, while three separate Subsidy Accounts were created for existing and new contributions.

- In 2006, two separate trusts were set up to finance the MDRI, with resources provided by the Fund and transfers of bilateral contributions from the PRGF Subsidy Account.

77. **The Fund also has a longstanding policy of providing emergency assistance to countries adversely affected by natural disasters and in the aftermath of conflicts.** The provision of ENDA dates back to the 1960s in the form of outright GRA purchases. ENDA is available to all qualifying members regardless of income level. In 2005, in order to help low-income countries cope with the impact of the Asian tsunami, the Board decided to subsidize the rate of charge on ENDA credit to PRGF-eligible members with bilateral contributor resources. The Fund's EPCA was initiated in 1995 and is also financed from the GRA. In 2001, the Board decided to establish an administered account to receive bilateral contributions to subsidize the rate of charge on EPCA credit to PRGF-eligible members.

Figure 13. Current Financial Structure of the Fund's Concessional Operations



78. **While the existing concessional arrangements have been tailored to address donor preferences and have so far broadly met the financing needs of LICs, several challenges will arise going forward:**

- The currently available concessional resources are limited and could be depleted quickly, while the estimated subsidization capacity of the PRGF-ESF Reserve Account offers limited ability to handle sustained high demand for concessional resources. As discussed above, near- and medium-term demand for the Fund's concessional financing could rise significantly, exceeding the available resources and the Reserve Account subsidization capacity.

- With the creation of new lending instruments (ESF), and the subsidization of ENDA and EPCA for PRGF-eligible members in recent years, fund-raising efforts have become increasingly *ad hoc*, and, the financing structure has become inflexible. For instance, while subsidy resources are available in the PRGF-ESF Trust, additional contributions would be required to subsidize ENDA/EPCA lending as PRGF-ESF subsidy resources cannot be used for this purpose.[50]

- Under the current financing framework, emergency assistance is less concessional than PRGF/ESF loans. Given LICs' debt-related vulnerabilities, it would be appropriate to provide emergency assistance on PRGF-ESF terms (see Section V.B), which would require additional resources and more flexible financing arrangements.

- Potential changes to LIC lending policies and facilities discussed above would also likely require additional resources and separate financing arrangements, further complicating the current structure.

B. Reform Options for Consideration

79. **In light of the potential scale of financing needs of LICs and possible changes to lending policies and facilities, it is timely to consider broad reforms to the current financing structure.** As discussed below, a shift to regular fund-raising cycles could make it easier to ensure that the Fund has the capacity to meet significantly higher projected financing needs in both the short and medium term, while a simplified and more flexible financing structure could make the management of concessional resource more efficient and could more easily accommodate policy changes and new facilities.

A Structured Approach to Future Fund-Raising

80. **As opposed to the current *ad hoc* approach, consideration could be given to shifting future fund-raising efforts to regular cycles, similar to IDA replenishments.**

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[50] In the recent fund-raising of subsidy resources for emergency assistance, several donors expressed a preference for diverting part of their existing contributions to the PRGF-ESF Trust to subsidize emergency assistance. This would represent a reallocation of part of existing subsidy resources in the PRGF-ESF Trust to emergency assistance (which is currently provided through the GRA) and would require Board approval and consents from all bilateral contributors to the PRGF-ESF Trust subsidy accounts.

Both loan and subsidy resources could be mobilized on, say, a five-year cycle to cover projected financing needs for all existing and new concessional facilities. Donors would be regularly updated on the use of resources. Toward the end of each cycle, financing needs for the new five-year period would be estimated as a basis for the next round of fund-raising. The resources of the PRGF-ESF Reserve Account could serve as a contingency buffer for unexpected needs and continue providing security to cover all bilateral loans.

81. **The main advantage of this approach is that it would help ensure that the Fund has sufficient resources to meet LICs' financing needs and allow donors to provide contributions in a structured way.** It would help avoid the need to seek *ad hoc* amendments to existing financing structure and donors' consent for establishing any new initiative. The approach would also strengthen the Fund's ability to handle unexpected spikes in demand through the use of the Reserve Account resources when needed. In addition, the approach would be unlikely to result in direct competition for donor contributions with the IDA given the relatively limited magnitude of resource needs by the Fund and the different purposes of the Fund and IDA financing.

A Simplified and More Flexible Financing Structure

82. **To make the existing financing structure more flexible, consideration could be given to establishing a new general subsidy account outside the PRGF-ESF Trust to receive contributions and provide subsidy financing with respect to all concessional lending, including under new facilities.** Under this approach, the existing subsidy accounts of the PRGF-ESF Trust would remain open to subsidize PRGF/ESF lending and allow those contributors wishing to continue earmarking their contributions in the future to do so. At the same time, contributors could transfer part or all of their existing subsidy contributions in the PRGF-ESF Trust to the new general account and/or make new contributions to this account. This approach could facilitate greater flexibility over time to the extent that donors provide new contributions to the general rather than the earmarked subsidy accounts. Resources in the general subsidy account would be available for any type of concessional lending when resources in specific accounts are exhausted.

83. **An alternative approach would be to create common pools of loan and subsidy resources to finance all concessional lending operations.** This would greatly streamline the framework for concessional financing and provide maximum flexibility for responding to changing demands for lending across facilities as well as to accommodate new initiatives that may be considered in the future. Such a reform would, however, involve a shift away from the approach adopted to date, under which resources in the PRGF-ESF Trust have been available only for certain specific types of lending, and toward an approach where all current and future Fund financing to LICs would be conducted via a single trust. One implication of such a reform is that contributors to both the Loan and Subsidy Accounts of the PRGF-ESF Trust would need to agree to the use of their existing contributions for a broader range of purposes. Furthermore, the reform would imply that donors no longer have the flexibility to

earmark new contributions for particular uses, representing a departure from past practice of seeking to accommodate donor preferences to the maximum extent possible.

84. **Under both approaches, the PRGF-ESF Trust instrument would need to be amended to allow loan resources to be used for all types of concessional lending.** The Reserve Account of the PRGF-ESF Trust would provide security to cover all types of lending. Both approaches would require Board decisions and consents from all current loan and subsidy contributors. This would entail an Executive Board decision amending the PRGF-ESF Trust Instrument that is adopted by an 85 percent majority of the total voting power. In addition, consents would be required from all current contributors to the Loan and Subsidy Accounts of the PRGF-ESF Trust.

VIII. Issues For Discussion

- Do Directors agree that the IMF's facilities and financing framework should become more flexible to address the diverse needs of LICs and their heightened exposure to global volatility?

- Do Directors agree that the Fund should maintain its ability to provide both medium- and short-term concessional financing and to accommodate members with limited financing that seek a program-based engagement to support their policies?

- Do Directors support a reform of the facilities architecture for LICs that would close gaps (short-term financing needs other than exogenous shocks, precautionary needs, and flexible emergency support), while reducing ambiguities and limiting overlaps? If so, which of the three broad reform models would they consider the most promising avenue to explore in the second stage of the review?

- In light of the erosion of access norms and limits and greater global volatility, do Directors agree that modifications to access policies should be explored in the second stage of the review?

- Do Directors agree that financing terms under the PRGF-ESF Trust remain appropriate, and that emergency assistance and short-term adjustment lending should be provided on the same terms? Should rules for blending concessional and GRA resources be revisited, and PRGF eligibility reviewed more regularly?

- Do Directors support making the conditionality framework applied under concessional facilities more flexible, including by adapting proposals made for the GRA? Do Directors agree that the protracted balance of payments problem standard remains relevant for medium- and longer-term adjustment lending to LICs, whereas a standard based on present needs should apply to short-term financing?

- How should the risk of insufficient concessional resources be addressed, in light of demands arising from the global crisis, greater exposure of LICs to volatility and in the event of possible reforms that would close gaps in the LIC facilities architecture?

- Do Directors agree that the current concessional financing framework needs to be made more flexible through a more structured and periodic approach to fund-raising that allows donors to make their contributions available to support the broad range of lending facilities? If so, which options should be explored further in the second stage of the review?