

20-11 A Possible IMF Pandemic Support Facility for Emerging-Market Countries

Matthew Fisher and Adnan Mazarei

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The International Monetary Fund (IMF) has thus far mounted a nimble and effective response to the COVID-19 pandemic, providing emergency financing of about \$25 billion to 72 countries¹ and immediate debt service relief to 27 low-income countries.² Looking ahead, however, the IMF is ill equipped to assist emerging-market countries (EMCs) facing pandemic-related fiscal and balance of payments difficulties.³ We believe that the Fund, as it adapts its strategy for meeting the challenges unleashed by the pandemic, urgently needs to develop a new temporary lending instrument that primarily serves EMCs: a Pandemic Support Facility (PSF).

There are at least two compelling arguments for the creation of such a facility. First, the COVID-19 pandemic has produced a global downturn that is unprecedented in modern times. The crisis is imposing severe adverse effects on emerging-market economies, and pandemic-related financing needs are likely to continue until the global economy returns to “normal.” Many EMCs will likely seek

Matthew Fisher is former deputy director of the Finance Department at the International Monetary Fund (IMF). **Adnan Mazarei** is nonresident senior fellow at the Peterson Institute for International Economics and former deputy director of the IMF’s Middle East and Central Asia Department. The authors are grateful for very helpful comments from Ruchir Agarwal, Kathleen Burke, Jérémie Cohen-Setton, Sean Hagan, Cullen Hendrix, Maury Obstfeld, Ted Truman, and Steve Weisman and to Madona Devasahayam and Cameron Fletcher for editorial assistance.

- 1 Emergency financing allows the Fund to provide assistance rapidly without the need to have a full-fledged program in place and without the more traditional IMF conditionality. Such support is typically followed by a conventional lending program.
- 2 The Fund has also doubled access to its emergency facilities—the Rapid Financing Instrument and the concessional Rapid Credit Facility. In addition, it has approved arrangements under Flexible Credit Lines for Chile, Colombia, and Peru, which have very strong policy frameworks and track records of economic performance. These arrangements are expected to be treated as precautionary. The Fund has also created a Short-Term Liquidity Facility, but it has not yet been used by any country. More recently, on July 13, the IMF temporarily increased, until April 6, 2021, the annual limit on access to the Fund’s nonconcessional resources from 145 percent of quota to 245 percent. There was a corresponding increase on the limit on access to concessional resources.
- 3 We also note that the recent G20 Debt Service Suspension Initiative, which allows a deferment of debt service falling due during May–December 2020 for low-income countries, does not cover middle-income EMCs. The G20 initiative applies to 73 of the countries covered by the World Bank’s International Development Association. See [https://g20.org/en/media/Documents/G20_FMCBG_Communique_EN_\(2\).pdf](https://g20.org/en/media/Documents/G20_FMCBG_Communique_EN_(2).pdf) (accessed on July 21, 2020).

financing from the Fund, including in support of debt restructurings. The timing of a return to normalcy, however, is very difficult to gauge given the dynamics of the pandemic and the extent of damage to the global economy.

Second, the pandemic-induced fiscal and balance of payments needs are fundamentally different from the challenges that the Fund's main lending facilities can address—Stand-By Arrangements (SBAs) (where a suitable mix of macroeconomic policies and financing is expected to achieve fiscal and balance of payments equilibrium) and Extended Fund Facilities (EFFs) (where equilibrium is to be attained by correcting structural imbalances over an extended period). Fund lending in the current circumstances should help countries address an exogenous shock that could be largely self-correcting over the medium term—though not without some scars. Consequently, Fund programs at this point should place less emphasis on adjustment than would be the case with the Fund's more traditional lending instruments.⁴

Thus the pandemic-generated fiscal and balance of payments needs justify the creation of a new lending instrument.⁵ And a new instrument that is specifically tailored to address the challenge of the pandemic might be attractive to countries that are concerned about the stigma of borrowing from the Fund.

The proposed PSF will need to be fundamentally different from the Fund's SBAs or EFFs. While those facilities could be modified to incorporate the features proposed here, against the backdrop of the Fund's policy on uniformity of treatment, reverting to normal SBA and EFF standards would be very difficult once the pandemic recedes. A dedicated pandemic facility would mean that countries devastated by COVID-19 will be granted exceptional flexibility, a leeway not anticipated in other cases in the future. We think it is much better to devise a new facility that would cordon off pandemic arrangements intended to be discontinued after the pandemic, rather than revisiting the entire structure of SBAs and EFFs at this stage. This approach combines short-term flexibility with minimized risks to the Fund's operations over the long term.

THE UNPRECEDENTED NATURE OF THE PANDEMIC-RELATED ECONOMIC SHOCK

The global economic crisis caused by the pandemic is the deepest since the Great Depression. In many ways, it combines profound supply and severe demand shocks.

4 This would in some ways replicate certain features of the Compensatory Financing Facility established in 1963 to help countries cope with temporary exogenous shocks that affected export earnings without resorting to undue and unnecessary adjustment. The facility underwent a number of modifications and was abolished in 2009, largely because of difficulty in distinguishing between shocks expected to be temporary and those expected to be permanent, as well as a lack of conditionality to ensure that appropriate policies would be implemented.

5 Of course, we have to bear in mind that there is a question as to whether the COVID-19 shock is temporary or not. If an effective vaccine or treatment is not developed and the pathogen becomes endemic, there are likely to be lower levels and growth rates of real GDP globally for a period of uncertain length.

- The supply shock is due in part to social distancing and confinement policies. Therefore, it is in large measure a *voluntary policy-induced* supply shock imposed for public health reasons. It is amplified by changes in consumer behavior (e.g., increased savings, less travel) in the face of the risk of contracting the virus.
- At the same time, EMCs are facing balance of payments pressures stemming from sharp declines in demand for their exports, commodity prices, workers' remittances, and tourism receipts, as well as capital outflows.

In addition, EMCs face an urgent need to increase spending on health care, expand the scale and scope of social safety nets, and adopt other measures to support the most vulnerable, while their fiscal accounts are under pressure from falling revenue. If the crisis remains underaddressed, it will lead to significant changes in income distribution and increases in poverty because of employment losses and limited social safety nets. Fiscal multipliers are likely to be considerably larger than during previous emergencies because government spending is likely to be more effective than in other times in preventing business shutdowns and bankruptcies. As the need for government spending surges, however, EMCs will likely encounter difficulties raising revenues and mobilizing domestic financing. Although some EMCs have very recently regained some access to private inflows, this improvement may not last, and other EMCs are likely to require Fund financing. Some countries are likely to face debt distress.

The pandemic-induced shock is also different from other balance of payments shocks because of incalculable and massive uncertainty regarding the magnitude and duration of the resulting downturn. For example, in late June 2020 the Fund revised sharply its projections for the contraction in the global economy in 2020 from 3 to 4.9 percent. For 2021, the world economy is expected to grow at 5.4 percent, but a second viral outbreak could instead lead to a 4.9 percent contraction. It is possible that the world could face a second wave of the pandemic in late 2020 or well into 2021. It seems unlikely that there will be a marked recovery in the global economy until an effective treatment and/or vaccine becomes widely available, the timing of which remains highly uncertain.

Even if or when an effective treatment or vaccine is deployed, a combination of higher private sector saving, lower investment in the face of weak demand, corporate and household balance sheet distress, and high levels of sovereign debt may well retard the recovery.

It is important to recognize the possibility that vaccines will have only limited effectiveness, so herd immunity may not be achievable. This could result in long-term changes in consumer behavior that could lead to more enduring impacts on EMCs. At this stage it is not clear to what degree the new postpandemic normal for commodity prices, trade flows, and other global conditions important for EMC growth will differ from those that prevailed before the pandemic.

ADJUSTING TO THE SHOCK

The extent and timing of fiscal and balance of payments adjustment during and following the pandemic are likely to be different from previous crises. To the extent that the shock is expected to be largely self-correcting, it would be desirable to provide financing to avoid unnecessary changes in economic

policies. Moreover, given the human toll of the pandemic, the socially acceptable amount and timing of adjustment will very likely be lower than in previous crises. Adjustment should therefore facilitate additional fiscal spending on health care and social protection throughout countries' recovery from the pandemic. Adjustments may need to be more gradual thereafter.

The nature of policy adjustment will depend on countries' fiscal and external positions, which can be broadly characterized in two categories. First, countries that were *in broad fiscal and external balance* prior to the pandemic may not need to alter their economic policies if sufficient financing is available to provide a bridge to normalization of the global economy. Because the postpandemic world will likely differ from the prepandemic world (e.g., with some structural changes to the pattern of commodity prices and trade flows), some economic policy adjustments may still be required, but it is premature to specify the extent and timing. To the extent that the rollover of existing debt or the availability of new money are constrained, even countries with no imbalances before the shock may be compelled to adjust policies somewhat during the pandemic, but at a more measured pace than was typical in previous crises.

Second, countries that *had imbalances* before the pandemic need to undertake economic policy adjustments to prevent a major deterioration in those imbalances. It would be desirable to cushion the adjustment by providing financing to help address the immediate external shock and the need for greater fiscal spending, as well as to mitigate risk of disorderly adjustment for themselves and for other countries.

For both categories of countries, the Fund can play its traditional role: helping to design policies that assist in laying the foundation for strong growth and, if necessary, adjustment policies that are minimally disruptive, while mobilizing external financing. Adjustment may need to be more gradual than in the pre-COVID-19 world.

POSSIBLE DESIGN OF A PANDEMIC SUPPORT FACILITY

A Pandemic Support Facility would allow the Fund to maintain its nimble and flexible crisis response. The approval of a new facility requires the support of executive directors holding at least 85 percent of the voting power. While this represents a high bar, the approval requirement arguably enhances the political commitment of all countries, including non-Paris Club creditors such as China, to provide financing and debt relief to the EMCs. The Fund's Executive Board would review the facility after one year. There would be a sunset provision after, say, four years, and a presumption that the facility would be terminated one year after an effective treatment and/or vaccine becomes widely available.

Lending arrangements under the PSF should provide a transition from emergency financing to possible SBA or EFF arrangements once there is greater clarity on the need for adjustment. PSF arrangements would cover a period of up to three years. Progress under the arrangements would be reviewed semiannually by the Fund's Executive Board. Quarterly disbursements would be subject to quantitative economic performance criteria to help ensure that appropriate policies are implemented, as described below. In addition, the Fund could consider making the quality of the receiving country's public health response subject to review, perhaps with inputs from the World Bank.

In the early stages of an arrangement the focus of the policies would be on ensuring adequate emergency spending on health care and support for the vulnerable; stabilization of the financial system; mobilization of external financing; and, perhaps only in cases of particularly large imbalances, some fiscal consolidation. Fund staff should work with country authorities to develop structural reform measures for implementation later in the arrangement. This would allow the Fund to move rapidly to provide financial support before the full reform agenda has been specified.

An important focus of the semiannual Executive Board reviews would be the timing of structural reform measures identified by country authorities and Fund staff, and the possible need for adjustment measures as there is greater clarity about the likely structural changes in commodity prices and trade flows. Under the PSF the policy content would be expected to increase over the life of the arrangement.

A key concern will be debt sustainability. Given the extraordinary uncertainty regarding the path of the pandemic, the global economy, the ability of EMC governments to raise resources domestically, and the functioning of global financial markets, it is difficult to conduct highly reliable debt sustainability analyses (DSAs).⁶ Therefore, a PSF program would, at the time of formulation, need to be based on a tentative DSA. Subsequently, if needed, this DSA would be updated during the program period and adjustments to the program made accordingly.

Let us consider three possible categories of countries.

First, for countries whose external debt is judged to be *clearly unsustainable* at the outset of the program, a debt restructuring will be necessary, covering debt to both bilateral and private creditors. Given the inherent uncertainty of the DSA during the pandemic, it is possible that an initial restructuring would not be sufficient to restore sustainability, and a subsequent debt operation might be required.

Second, for countries whose external debt is *clearly sustainable*, there will be no need for a debt restructuring. In such circumstances Fund financing would be intended to help catalyze new financing from private and official sources. For these countries, the Fund could provide resources even above its normal access levels (though the need for exceptional access has been reduced because of the recent increase in access to Fund's nonconcessional resources).⁷

Third, for countries where the sustainability of external debt is *highly uncertain*, there will need to be a reprofiling of debt service falling due during a standstill, overseen by the Fund for both official and private creditors (Gelpern, Hagan, and Mazarei 2020). Using a country's resources to pay creditors is not a priority in a pandemic given the high human cost. And there will be little political

6 For a discussion of some of the uncertainties involved in debt sustainability analyses, see Debrun et al. (2019).

7 The *normal access* limits under IMF programs are currently 245 percent annually of a country's IMF quota (which broadly reflects the country's position in the global economy) and a cumulative limit over the life of the program of 435 percent of its quota, net of scheduled repayments. The Fund could provide *exceptional access* above limits provided a country satisfies a predetermined set of criteria.

Table 1
Key differences between IMF Stand-By Arrangements/Extended Fund Facilities and the proposed Pandemic Support Facility

Features^a	Stand-By Arrangement (SBA)/ Extended Fund Facility (EFF)	Pandemic Support Facility
<i>Purpose</i>	SBA is the Fund's main facility for addressing short-term balance of payments needs. EFF is for addressing countries with serious balance of payments problems because of structural weaknesses. It entails implementing medium-term structural reforms.	Temporary facility designed to manage the large fiscal and balance of payments needs associated with COVID-19.
<i>Conditionality</i>	Standard IMF conditionality guidelines on macroeconomic policies, with emphasis on fiscal consolidation and structural reforms.	More lenient conditionality, with regard to degree and pace of fiscal consolidation and less focus on structural reforms in the first year of the program.
<i>Debt sustainability</i>	Debt sustainability is a requirement. For exceptional levels of access to IMF financing, debt sustainability with high probability.	Less focus on debt sustainability at the time of program design in light of exceptionally high uncertainty due to COVID-19. For exceptional levels of access to IMF financing, debt sustainability with high probability.
<i>Duration</i>	1-2 years; no more than 3 years	1-3 years
<i>Terms of repayment</i>	3¼-5 years for SBAs; 4-10 years for EFFs	4-7 years

a. Access limits, standard rates of charge, surcharges, commitment fee, and service charges would be identical to those applicable to EFFs.

tolerance for using IMF resources to pay private creditors. Access to Fund resources will be kept within the normal limits, and access levels and the possible need for debt reduction revisited with updates to DSAs.

There is a presumption that phasing of Fund disbursements would be uniform, though some front loading should be contemplated if foreign exchange reserves have fallen significantly.

The likely duration of the pandemic shock and global economic recovery would justify longer repayment periods than those available under SBAs (3¼-5 years). The repayment period under the PSF would be, say, 4-7 years (shorter than the repayment terms for EFFs, 4-10 years). It would be understood that if a country's balance of payments position improved more rapidly than expected, it would have an obligation to make early repayments to the Fund. By the same token, if pandemic-related balance of payments pressures persist, members may need follow-on arrangements to address their financing needs, including meeting obligations to the Fund.

Table 1 summarizes the key differences between the proposed PSF and the Fund's SBAs and EFFs. Further work would be required to estimate the likely scale of demand for financing under the PSF and the implications for the adequacy of the Fund's financial resources.⁸

8 For a discussion of the adequacy of the Fund's financial resources, see Truman (2020).

Box 1 Restructuring of bilateral claims

The consolidation of bilateral claims would be comprehensive, covering all debt service (and arrears, if any) on all pre-cutoff date official and officially supported lending with an original maturity of more than one year.

The full or partial consolidation of moratorium interest should be considered on a case-by-case basis.

All security arrangements, such as the payment of export proceeds into offshore escrow accounts and payments in kind, would be suspended for the duration of the consolidation period.

A new cutoff date (the date before which debts must have been contracted in order to be eligible for restructuring) would be established for, say, one month before approval of the Pandemic Support Facility arrangement.

Creditors would be expected to continue disbursing loans used to finance existing investment projects.

EXTERNAL FINANCING

It is likely that EMCs' financing requirements will be substantial. The approval of a PSF would require concrete financing assurances from a country's creditors for the first year so that the country's program is fully financed and strong prospects that the remaining part of the program would be adequately financed. As with Chapter 11 for corporations, there should be a presumption that all creditors will maintain their exposure and, to the extent feasible, provide new money.

The financing arrangements for individual countries should be determined on a case-by-case basis, taking into account the composition of a country's creditors and its debt service profile during the program. Key components could include:

- *The World Bank and other multilateral institutions.* The Fund should engage with the Bank and other multilateral institutions to seek understandings that their exposure would be increased.
- *Bilateral creditors.* The Fund would need concrete assurances that all bilateral creditors would provide comprehensive relief broadly in line with Paris Club principles (box 1).
- *International bonds.* For large amortizations that fall due during the program period, bonds may need to be restructured, to postpone—and possibly reduce—payments of principal and interest. The details of a restructuring should be specified during the negotiation between a country and its creditors. Because several countries may need to restructure their bonds as a result of the pandemic shock, it might be helpful for the official community to consider developing a menu of instruments to be issued during a restructuring.⁹ The use of a common structure would help to provide market liquidity for the new instruments.

⁹ Similarly, during the late 1980s, the Brady Initiative provided a broadly common menu for the restructuring of commercial bank claims.

- *Other private sector claims.* Consideration should be given, on a case-by-case basis, to restructuring of nonbonded private claims, including bank credit lines and trade credit.

CONCLUDING SUMMARY

A Pandemic Support Facility such as the one proposed here will (1) have significant humanitarian and economic benefits at a time of exceptional stress for emerging-market countries, (2) help meet the EMCs' financing needs and policy adjustments needed by EMCs at a time of high uncertainty regarding the desirability of adjustment and the length and magnitude of the pandemic and its economic impact, (3) allow a more flexible application of the Fund's policies, especially related to the need for adjustment and the use of debt sustainability analyses in IMF programs, and (4) provide for more lenient repayment periods.

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