

BUFF/02/159

September 20, 2002

**Summing Up by the Acting Chair
Access Policy in Capital Account Crises
Executive Board Meeting 02/94
September 6, 2002**

Directors welcomed the opportunity to consider elements of a strengthened framework for the policy on exceptional access to the Fund's resources—i.e., access that exceeds the limits under the credit tranches and the Extended Fund Facility (EFF). Our discussion today has focused particularly on access policy and crisis resolution in cases where a combination of adjustment and financing is likely to be sufficient to put a country on a stable medium-term path. In some other cases, a restructuring of private claims may be necessary. Our work on ways to strengthen the framework for debt restructurings—including the sovereign debt restructuring mechanism and the contractual approach—and clarifying the lending into arrears policy are separate strands for developing the crisis resolution strategy. Access policy is also closely related to our ongoing discussions on the size of the Fund, and the Twelfth General Review of Quotas, with a number of Directors noting that progress on this issue, including on the distribution of quotas, would help to address some of the concerns about exceptional access.

Directors discussed the exceptional access policy in the context of the Fund's response to the challenges arising from the increasing integration of global financial markets in the last decade. This integration has helped to support a rapid expansion of investment and activity in many emerging market countries, but has also exposed these countries to crises caused by rapid reversals of capital flows. The Fund has responded to the challenges posed by these modern capital account crises by strengthening its crisis prevention capabilities and, in some cases, by helping meet members' unusually large financing needs. Directors agreed that exceptional access will sometimes be necessary if the Fund is to provide meaningful assistance to members facing a capital account crisis, but that the policies on such access need to be strengthened to ensure that it remains exceptional. In this context, some Directors noted that the exceptional circumstances clause may continue to be needed occasionally also for balance of payments problems in the current account.

Our discussion today has been informed by the experience gained in past exceptional access cases, beginning with Mexico's Stand-By Arrangement (SBA) in 1995. Several of the programs supported by exceptional access have been quite successful in helping the member achieve external viability, resume growth with limited vulnerability, and regain access to private markets, although more slowly than at first expected. In other countries, however, the combination of adjustment and exceptional access in the context of the associated political and external environment was not sufficient to avoid a restructuring of obligations. It was

noted, however, that in all cases the borrowing members have remained current on their repayment obligations to the Fund. From a broader perspective, Directors also noted that, while some moral hazard is bound to be present in Fund lending, there is little evidence that the use of exceptional access in general has had large effects on moral hazard by increasing investor or country risk-taking.

Directors agreed that more clearly defined criteria regarding the appropriate use of exceptional access in capital account crises are needed to help shape the expectations of members and markets, provide a benchmark for difficult decisions regarding program design and access, safeguard Fund resources, and ensure uniformity of treatment of members. Directors generally considered that (at a minimum) the following criteria would need to be met to justify exceptional access for members facing a capital account crisis:

(i) The member is experiencing exceptional balance of payments pressures on the capital account resulting in a need for Fund financing that cannot be met within the normal limits;

(ii) A rigorous and systematic analysis indicates that there is a high probability that debt will remain sustainable;

(iii) The member has good prospects of regaining access to private capital markets within the time Fund resources would be outstanding, so that the Fund's financing would provide a bridge; and

(iv) The policy program of the member country provides a reasonably strong prospect of success, including not only the member's adjustment plans but also its institutional and political capacity to deliver that adjustment.

In discussing the aforementioned criteria, Directors emphasized in particular the importance of rigorous debt sustainability analyses to support requests for exceptional access. Several Directors saw scope for further strengthening the criteria so as to ensure their strict application. Directors underscored the importance of involving the private sector for program success, and a number of them expressed the view that the member's best efforts to secure private sector involvement in program financing should be an important consideration for justifying exceptional access.

A few Directors suggested further narrowing the definition of capital account crises that could warrant exceptional access by establishing a formal criterion relating to problems of contagion or the potential for systemic effects. Many other Directors, however, considered that such a criterion could create a bias toward higher access for larger members, which could not be reconciled with the principle of uniformity of treatment. Directors recognized that the Fund should be prepared to provide access above the normal limits in cases where the member's problems have regional or systemic implications, when the other criteria are met.

Directors concurred that the member's balance of payments needs remain a key criterion in determining access in individual cases, while recognizing that measurement of need in financial crises is subject to an unusual degree of uncertainty. Stocks of financial claims can be very large, and can potentially translate into a large balance of payments need. In this context, several Directors highlighted the limitations of the gross financing needs variable, which is a commonly reported measure of need in Fund-supported programs.

A number of Directors noted that, in capital account crises, access in percent of quotas has varied widely, partly because, for some members, the quota may not reflect the relative size of the economy and/or their integration into international capital markets. Most Directors considered, nevertheless, that quotas should remain the fundamental metric for access. Many Directors recognized that alternative metrics, such as GDP, exports, gross reserves, and calculated quotas, could provide additional perspectives on the scale of access in individual cases, even though they would not give unequivocal guidance. In this light, a few Directors recommended that further work be done to support assessments of the appropriate scale of access in more detail.

Most Directors agreed that even when the need was large, Fund financing in exceptional access cases had in practice covered only a portion of the gross financing need, with financing from the private sector and from other official sources filling the balance. Directors emphasized that efforts to involve private sector creditors in program financing should be continued, but it was also recognized that concerted or involuntary action by such creditors could be associated with a slow return of confidence and market access. Several Directors encouraged further consideration of the role of private sector involvement in exceptional access cases.

Directors supported strengthening the procedures for decision making on access proposals above the normal access limits to provide additional safeguards and enhance accountability, and the Board agreed to the following measures:

(i) *Raising the burden of proof required in program documents as set out in the staff paper.* This would include thorough discussion of need and the proposed level of access, a rigorous analysis of debt sustainability, and an assessment of the risks to the Fund arising from the exposure and its effect on liquidity;

(ii) *Formalizing requirements regarding early Board consultation on the status of negotiations in exceptional access cases.* The modalities of the Board's involvement will be further worked out, building on the practice under which the Board has confidential briefings on the broad strategy of the program and the case for access above normal limits before negotiations are concluded; and

(iii) *Requiring an ex post evaluation by the staff of programs supported by exceptional access within a year after the end of the arrangement,* with a number of Directors suggesting that the Independent Evaluation Office also consider conducting such evaluations.

Directors also considered the possibility of establishing a presumption of public disclosure of Fund staff reports on programs supported by exceptional access. A majority of the Board held the view that, in particular in these cases, there would be a high premium on increasing public understanding and credibility of the program strategy. Many other Directors, however, were concerned that moving to a presumption of publication of such staff reports might not be easily reconcilable with the need for frank assessments of the risks involved. Directors agreed to return to this issue on the occasion of the next review of the Fund's transparency policy in June 2003.

Directors discussed the possibility of requiring a supermajority of Board votes to approve exceptional access. They generally agreed that such a fundamental change to the governance structure of the Fund—which would necessitate a change in the Articles of Agreement—should not be pursued at this time. A few Directors were in favor of separating Board decisions on exceptional access from the approval of the program. Several Directors noted, however, that the merits of the access proposal could not be considered independently from the program, and cautioned against procedures that could slow the approval process.

Directors discussed the possibility of introducing a presumptive limit on cumulative exceptional access to provide an additional restraint on the use of the Fund's resources. Directors were opposed to the establishment of such a limit, noting that it could not preclude access above this limit without fundamentally constraining the Fund's capacity to respond to crises in its member countries where access above the high limit might be justified. They also pointed to a number of difficult practical hurdles that a limit or norm on exceptional access would raise, in particular, the problem of choosing the right level for a high limit, and the complexity of rules that would need to be defined around a two-tier system of access limits. Furthermore, some Directors were concerned that a presumptive access limit or norm would only be credible to the extent that it was adhered to. Past decisions on high access above the limits considered would make it more difficult to establish credibility.

Turning to prudential considerations regarding exceptional access cases, Directors agreed that more systematic and comprehensive information regarding the member country's capacity to repay the Fund and the Fund's exposure to the member country is needed to underpin judgments about the appropriateness of the proposed access levels in individual cases. In this context, Directors also considered setting a maximum absolute exposure level for a single member above which additional precautionary balances would immediately be accumulated through the burden-sharing mechanism. While a few Directors saw merit in such a proposal, most Directors opposed this idea, as it would raise difficult issues regarding the uniformity of treatment of members in terms of access. They were also concerned that using the burden-sharing mechanism could signal a lack of confidence of the Fund in the member country's economic program and ability to repay the Fund. Some Directors called for an increase in quotas to provide the Fund with adequate resources to deal with the new type of crises.

Directors also had a preliminary discussion of possible changes in the terms and conditions of Fund lending above the limits to affect incentives that apply to exceptional access cases. Most Directors agreed that the scope for increasing the rate of charge to discourage exceptional access appears limited. A number of Directors were of the view that, since some capital account crises are unlikely to reverse as quickly as foreseen in the Supplemental Reserve Facility (SRF), lending at somewhat longer maturities should be available if the Fund is to contribute effectively in some of these cases. Other Directors, however, cautioned that such proposals could blur the distinction between SRF and SBA resources, and would warrant a fuller review. Many Directors also expressed interest in further considering the establishment of a presumption that SRF resources would be used when the cumulative access exceeds the limits under the credit tranches and the EFF. A few Directors also noted the importance of the policy on early repurchases in this context.

The current discussion has been fruitful in developing consensus in a number of areas. Staff will prepare a follow-up paper before the end of the year on how best to put this new framework in place, including procedures for early Board consultation in cases where exceptional access is considered, and issues related to private sector involvement in these cases. This paper will also include further consideration of the appropriate maturity of Fund lending in capital account crises, and of the related issue of the mix between SRF and SBA resources. At that discussion, the Board will also conduct the regular review of access policy under the credit tranches and the EFF.