INTERNATIONAL MONETARY FUND

Review of Exceptional Access Policy

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In Consultation with other Departments

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I. INTRODUCTION

1. **This paper reviews the experience with the framework for exceptional access that was approved by the Board in September 2002 and February 2003.**[1] The objectives of the new framework are to enhance the clarity and predictability for both members and markets of the Fund's response in crisis resolution, and to strengthen safeguards of the Fund's resources (Box 1). Exceptional access is defined as access by a member to the Fund's general resources, under any type of Fund financing, in excess of an annual limit of 100 percent of the member's quota, or a cumulative limit (net of scheduled repurchases) of 300 percent of the member's quota. When approving this framework, Directors looked forward to an opportunity to assess experience under it after one year, and this paper responds to that request.

2. **The new framework became fully operational in February 2003 and it has been applied in the recent decisions on Argentina and Brazil.**[2] Argentina's three-year stand-by arrangement with access of SDR 9 billion (424 percent of quota) was approved on September 20, 2003 (EBS/03/130, 9/15/03, Sup. 1).[3] Brazil's 15-month extension and augmentation was approved on December 12, 2003 (EBS/03/157, 11/24/03), and the arrangement became precautionary at that time.[4] The augmentation equaled SDR 4.5 billion (150 percent of quota), which together with the undrawn balance from the existing stand-by arrangement brought available access under the extended stand-by to SDR 10.2 billion (about 336 percent of quota).

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[1] See "Access Policy in Capital Account Crises," (SM/02/246; 7/30/02) and the Acting Chair's Summing Up (BUFF/02/159; 9/20/02), and the follow-up paper "Access Policy in Capital Account Crises—Modifications to the Supplemental Reserve Facility and Follow-Up Issues Related to Exceptional Access Policy," (SM/03/20; 1/14/03) and the Acting Chair's Summing Up (BUFF/03/28; 3/5/03).

[2] Dominican Republic's stand-by arrangement approved on August 29, 2003 involved total access of 200 percent of quota over two years (100 percent of quota annualized, the maximum allowed under the normal limits). See "Dominican Republic—Staff Report for the 2003 Article IV Consultation and Request for Stand-By Arrangement" (EBS/03/116, 8/6/03).

[3] Prior to the date when the framework became operational, the Board had approved a seven-month stand-by for Argentina on January 24, 2003 (EBS/03/5, 1/17/03) which also involved exceptional access.

[4] Brazil also requested an extension of repurchases (totaling SDR 8 billion) from an expectations to an obligations basis in 2005 and 2006. The request was based on the view that market concerns about the repayment profile—which contained a spike in 2005—could inhibit the restoration of confidence (EBS/03/157, 11/24/03).

Box 1. The Exceptional Access Framework 1/

The framework attempts to find a sensible balance among the following objectives for exceptional access:

- To define more clearly and narrowly cases when exceptional access may be appropriate, with increasing constraints as higher access is considered.
- To provide more clarity on the criteria used by the Fund to determine when it may be appropriate to consider exceptional access and when a restructuring of private claims is warranted.
- To provide a better basis for judgments on the appropriate scale of access in capital account crises.
- To put in place internal safeguards to ensure that these judgments are made carefully, risks are appropriately weighed, and the Board involved.
- To preserve the Fund's financial position and safeguard its resources. The Board recently reiterated that the exceptional access framework is a key pillar of the Fund's enhanced risk management framework. 2/

The Board generally considered that (at a minimum) the following four substantive criteria would need to be met to justify exceptional access for members facing capital account crises:

(1) 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.

(2) A rigorous and systematic analysis indicates that there is a high probability that the debt will remain sustainable.

(3) The member has good prospects of regaining access to private markets within the time Fund resources would be outstanding.

(4) 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.

The framework also established stronger procedures for decision-making on exceptional access to reinforce safeguards and enhance accountability. The procedures include:

- Systematic Board consultations on program negotiations, notably through *confidential informal briefings*. Directors are provided with a short note outlining the following: (i) tentative diagnosis of the problem; (ii) the outlines of the needed measures; (iii) the basis for judgment that exceptional access may be necessary and appropriate, with a preliminary evaluation of the four substantive criteria; and (iv) the likely timetable for discussions. Directors are also provided with a separate informal note evaluating the case for exceptional access based on further consideration of the four substantive criteria.
- A higher burden of proof in *program documentation*. Staff reports proposing exceptional access have to include: a consideration of each of the four criteria; a thorough discussion of balance of payments need and proposed access; a comparison of proposed access with other metrics aside from quota; and systematic and comprehensive information on capacity to repay the Fund. The Board is also provided with an assessment of risks to the Fund arising from the exposure and its effect on liquidity.
- Ex post evaluations of programs within one year of the end of the arrangement.

1/ See "Access Policy in Capital Account Crises," (SM/02/246; 7/30/02), the Acting Chair's Summing Up (BUFF/02/159; 9/20/02), "Access Policy in Capital Account Crises—Modifications to the Supplemental Reserve Facility and Follow-Up Issues Related to Exceptional Access Policy," (SM/03/20; 1/14/03) and the Acting Chair's Summing Up (BUFF/03/28; 3/5/03).

2/ "The Acting Chair's Summing Up--Financial Risk in the Fund and the Level of Precautionary Balances" (BUFF/04/35; 3/2/04).

3. **In the Executive Board's discussions on Argentina and Brazil, three key and interrelated issues came into sharp relief.** First was the issue of how to apply a framework designed with capital account crises in mind in two situations where the member's need was related to a preexisting large exposure but not to immediate strains on the capital account. Second, while the cases are very different, the decisions to continue supporting Argentina's and Brazil's adjustment programs through further lending raised questions about the circumstances under which the Fund should expect to be repaid after high exposures. Third, Brazil's request for a precautionary extension and augmentation raised questions about when and how exceptional access might be used in a precautionary setting. The current paper focuses on the first two issues; the third issue will be taken up in a separate paper scheduled for discussion in June.

4. **The paper is organized as follows:** Section II addresses the application of the access criteria and framework when the balance of payments need does not arise from an immediate crisis. Section II also reviews the experience with the four criteria, documentation requirements, and early Board involvement in the cases of Argentina and Brazil, before turning to the experience with the presumption that the Supplemental Reserve Facility (SRF) would be used for lending in capital account crises. Section III discusses the envisaged circumstances for repurchases of exceptional access in the current high access cases, drawing on past experience. The paper concludes with issues for discussion.

II. Review of the Experience with the New Framework

5. The new framework for exceptional access includes four substantive criteria, procedures for early Board consultation when exceptional access is considered, additional information requirements to raise the burden of proof, and a presumption that the Supplemental Reserve Facility (SRF) would be used for exceptional access in capital account crises. This section takes up each in turn.

A. Applying the Exceptional Access Criteria

6. **The staff reports for Argentina and Brazil tested these members' requests for exceptional access against the four criteria, and neither request met all four** (Table 1). Argentina's debt was considered not to be sustainable in the absence of a restructuring (criterion 2) and prospects were not good for regaining access to international capital markets within the time Fund resources were outstanding (criterion 3). However, it had been foreseen in the exceptional access framework that countries in the process of restructuring debt would not meet all of the criteria. In approving the new framework for exceptional access in capital account crises in February 2003, Directors generally agreed that access in debt restructuring cases would normally be expected to be within the access limits, although there could be rare circumstances warranting exceptional access.[5] For Brazil, it was recognized that there was no

[5] See BUFF/03/28, 3/5/2003.

Table 1. Argentina, Brazil and the Four Substantive Criteria for Exceptional Access in Capital Account Crises 1/

	Argentina	**Brazil**
Criterion 1: "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."	Argentina's exceptional access was justified on grounds of the large financing needs over the program period, mainly reflecting the need to restructure public and private debt and to rebuild reserves as well as to make repurchases to the Fund. After the crisis in 2000-01 and the government's default in December 2001, the macroeconomic situation had stabilized and begun to improve under the transitional Fund-supported program.	In Brazil, the balance of payments need was potential rather than actual, as evidenced by the authorities' indication to treat the arrangement as precautionary. The staff report argued that Brazil remained vulnerable to a worsening of market sentiment given its exceptionally large gross financing requirement and still weak reserves position, and a ratio of gross reserves to short-term debt below 1. The proposed access would allow Brazil to withstand a shock of about half the size of the one that it suffered in 2002-03.
Criterion 2: "A rigorous and systematic analysis indicates that there is a high probability that the debt will remain sustainable."	Pending the debt restructuring, Argentina's debt was not sustainable, and the Fund lends under its "lending-into-arrears"-policy. A baseline debt sustainability analysis showed that with a constant primary surplus of 3 percent of GDP during 2004-10, even with generous rollover assumptions and a complete write-down of Argentina's previously unrestructured (Phase 2) debt, financing gaps would emerge.	For Brazil the debt was considered sustainable so long as fiscal targets were met and market confidence sustained. Although the debt dynamics remained vulnerable to unfavorable developments in macroeconomic variables, the staff's analysis showed a decline in the public debt ratio over the medium term as long as the targeted primary fiscal surplus of about 4.25 percent of GDP was adhered to and market confidence sustained.
Criterion 3: "The member has good prospects of regaining access to private markets within the time Fund resources would be outstanding."	Argentina was considered unlikely to re-enter international capital markets during the time Fund resources would be outstanding.	This criterion was not relevant for Brazil. The country already enjoyed access to private capital markets, and was expected to be able to quickly regain such access in the event of a sudden loss due to contagion rather than domestic policy.
Criterion 4: "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."	The program was exposed to a number of significant risks, but on balance prospects for success outweighed the risks. The Board recognized as key risks the uncertain domestic political support for important structural reforms under the program, the authorities' decision to fall temporarily into arrears with the Fund, and the lack of specificity of key fiscal and banking reforms crucial for sustainability—especially with regard to the medium-term primary surplus target and bank compensation policy.	Brazil's program was considered to have reasonably strong prospects of success. The authorities had established a strong track record of policy performance under the 15-month SBA, and the prospects for continued strong performance were deemed to be good.

1/ Source: Staff reports on Argentina (EBS/03/130, Supplement 1, 9/15/2003; and Supplement 3, 9/16/03) and Brazil (EBS/03/157, 11/24/03), and the related summings up.

actual balance of payments need (as required under criterion 1) and that re-entry to private capital markets was not directly applicable since Brazil had such access.

7. **The Board may want to consider how the exceptional access criteria should apply when members are not experiencing a capital account crisis.** Based on the record since 1995, the new framework for exceptional access was designed to guide and constrain decisions on access for members experiencing a capital account crisis and with little outstanding use of Fund credit. While the large Fund exposures to Argentina and Brazil were built up during crisis periods, neither member was in the midst of the sort of crisis envisaged in the framework at the time of the recent decisions to grant exceptional access, and therefore it was impossible for either to satisfy all the criteria. The following paragraphs review the circumstances when exceptional access may be considered (capital account crises; when the outstanding access is already very high; when the balance of payments need is potential rather than actual; and other situations) and propose guidelines for decision-making. Specifically, staff proposes to clarify that the four criteria continue to apply in capital account crises, and that in all other cases, access decisions be underpinned by the principles on which the four criteria are based (see paragraph 13).

(i) In capital account crises

8. **Most of the requests since 1995 for exceptional access have been made by members experiencing capital account crisis**, and the now high exposures of the Fund to these members were built up during such crises. Prior to the elaboration of the framework for exceptional access, decisions were based on the SRF decision, or the clause in the 1983 access policy under which the Fund may, in exceptional circumstances, approve stand-by or extended arrangements involving amounts in excess of the access limits.[6] While the Board had refrained from defining those exceptional circumstances, the repeated use since the mid-1990s of exceptional access in capital account crises highlighted the need for a framework to guide and constrain access decisions in such situations. Experience shows that capital account crises are likely to be intermittent, but the related decisions on access are expected to remain among the most important and difficult the Fund will make. The four access criteria developed in the Board's reviews of access policy during 2002 and 2003 remain appropriate for capital account crises.[7]

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[6] See "The Chairman's Summing Up at the Conclusion of the Discussion on Decisions on the Amount of Access in Individual Cases," EBM/83/167, 12/2/83. The Executive Board has on several occasions reaffirmed the exceptional circumstances clause, most recently in Decision No. 12932-(03/6), January 31, 2003.

[7] The September 2002 summing up stated "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:" (after which the four criteria are given). See BUFF/02/159, 9/20/2002.

(ii) When the member has high outstanding cumulative access

9. **Fund arrangements are based on an expectation that programmed adjustment and reform measures together with financing from the Fund and other sources will enable the member country to repay on schedule.** This principle is particularly important when exceptional access is considered, since the Fund is taking an unusual risk, and the new policies on exceptional access are intended partly to reduce the risk that exceptional access is granted inappropriately. Nevertheless, there are some cases where the member's balance of payments situation did not improve as quickly as originally expected, as in Argentina, Brazil, Uruguay, and Turkey.[8]

10. **In cases where the balance of payments does not improve as envisaged, the Fund may be requested to provide financial assistance to support the member's adjustment program through a subsequent arrangement.** When provided in the context of an appropriate strategy to reduce Fund exposure over time, financing from the Fund may help to protect the revolving character of Fund resources. The record on repayments of high exposures to the Fund, and strategies for achieving this are considered in Section III below.

11. **For a member with cumulative access above 300 percent of quota, even an arrangement providing a small amount of access is treated as involving exceptional access, whether the request exceeds the annual access limit or not.** This ensures thorough consideration of any request for further access. However, in some circumstances an arrangement with relatively low, and possibly precautionary access, may be appropriate, and indeed facilitate exit from exceptional use of Fund resources.[9]

12. **The choice of a policy approach involves balancing rules and discretion.** There seems to be general agreement that the Fund must retain discretion to lend in emergencies, but that this should be subject to constraints. A contrasting approach to the one proposed by staff (see below) would require that all four criteria, as defined for capital account crises, would need to be met for *any* request for exceptional access. This would normally preclude any exceptional access except in capital account crises, including for members with high

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[8] Sometimes the problem may be addressed by extending repurchase expectations to an obligations basis. Under an SRF-supported program, repurchases are programmed on an expectations basis, and thus an extension to obligations basis could be requested if actual adjustment is slower than programmed. Repurchases associated with resources provided in the credit tranches or under the EFF are programmed on an obligations basis, and extensions of the related repurchase expectations may be requested if the balance of payments does not improve rapidly enough to allow the expectations to be met.

[9] This paper does not discuss the special circumstances that may justify exceptional access as a form of bridging loans in cases of protracted arrears to the Fund. This issue will be dealt with in another staff paper.

preexisting exposures. Also, limiting exceptional access to cases where a capital account crisis was under way could reduce the Fund's role in crisis prevention. Such a policy, if applied, would be both clear and consistent with a desire to constrain the use of exceptional access within very narrow bounds. However, if circumstances arose in which the Fund found it needed to make frequent exceptions to such a policy, it would undermine an important purpose of the exercise, which was to clarify—to members and markets—the conditions under which exceptional access would be provided.

13. **The staff proposes that the principles embodied in the four exceptional access criteria underpin any decisions on access when a member has a preexisting high exposure.** While it is recognized that the member cannot meet all of the criteria as specified for capital account crises, any request for exceptional access would need to demonstrate that: (i) the member has an actual or potential 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 its debt will remain or be made sustainable; (iii) the prospects for achieving the necessary improvement in the balance of payments are good; and (iv) the policy program of the member provides a strong prospect of success, including not only the member's adjustment plans but also its institutional and political capacity to deliver that adjustment. These principles, which are grounded in the Articles of Agreement, both allow the Fund to give members the support they need to overcome their difficulties without measures unnecessarily harmful to themselves or others, as well as to safeguard Fund resources and support a member's capacity to repay the Fund.

14. **In addition, any request for exceptional access would need to satisfy all other elements of the framework.** In particular, any request would meet the requirements for early involvement of the Executive Board, and the increased burden of proof (discussed further below). There would also be a presumption that the SRF would be used for exceptional access where the balance of payments is expected to improve rapidly, although this condition will not always be satisfied.

(iii) When the member seeks a precautionary arrangement

15. **The decision to meet Brazil's request for an extension and augmentation of its stand-by reopened questions about when exceptional access in a precautionary setting might be appropriate.** The request for a precautionary extension was seen as facilitating Brazil's exit from exceptional use of Fund resources. The staff papers evaluated Brazil's compliance with the four criteria, and recognized at the same time that, since Brazil's balance of payments need was potential rather than actual, at least the first criterion could not be

met.[10] The staff is preparing a further paper on precautionary arrangements for Board discussion in June (Box 2).

Box 2. Exceptional Access When the Need is Potential Rather than Actual

Directors have discussed the pros and cons of using exceptional access in precautionary arrangements, including under the Supplemental Reserve Facility (SRF), on several occasions. These include the discussion of how precautionary arrangements could be adapted to achieve some of the objectives of the now expired Contingent Credit Lines (CCL) and Brazil's request for extension and augmentation of its stand-by arrangement in December 2003.[1/] The June 2003 staff paper on precautionary arrangements proposed modifying the SRF to allow its resources to be committed in precautionary settings, when the potential need relates to vulnerability to a capital account shock. The proposal was made in the context of a package of reforms to adapt precautionary arrangements for crisis intervention.

The Executive Board has not reached a consensus to change policies on exceptional access in precautionary settings, and the issues will be considered in a further staff paper. The paper will take a fresh look at the role of such arrangements in helping to reduce vulnerability to crisis, both as part of an exit strategy from exceptional access and in other circumstances. It will also examine specific issues and questions that Directors have raised on various occasions: the circumstances and potential balance of payments needs that these arrangements would address; the likely implications for debtor and creditor behavior, and for the Fund's finances and liquidity; and the circumstances when exceptional access would provide a strong positive signal to markets, rather than one of vulnerability. It will consider the lessons from the CCL (in particular relating to the exit and stigma problems) and identify which objectives of that facility are worth aiming at. It will also clarify how members would qualify for exceptional access under precautionary arrangements (e.g., exit from use of exceptional access), and how potential balance of payments need would be defined. The paper will also address how the SRF could be modified to allow its use in precautionary settings, when the potential balance of payments need relates to vulnerability to a capital account shock that, if it occurs, is likely to reverse quickly.

1/ See "Adapting Precautionary Arrangements to Crisis Prevention" (SM/03/207, 6/11/2003) and the Acting Chair's Summing Up (BUFF/03/112, 7/9/03); "Completion of the Review of the Contingent Credit Lines and Consideration of Some Possible Alternatives," (SM/03/372, 11/12/2003) and the Acting Chair's Summing Up (BUFF/03/213, 12/3/2003).

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[10] The applicability of the four criteria became blurred in the context of the June 2003 discussion on adapting precautionary arrangements to crisis prevention. The summing up stated that "the recently adopted new criteria and procedures for exceptional access would apply to all arrangements". However, this is in contrast to the earlier statement that "the Fund's policy on access already provides for the flexibility in precautionary settings to exceed the normal access limits".

(iv) Other "exceptional circumstances"

16. **As set out in 1983, the Fund may approve stand-by or extended arrangements that provide for amounts in excess of the access limits in exceptional circumstances.** The Board has refrained from defining those exceptional circumstances, given the varying needs of members, and the importance of the Fund being ready to respond with exceptional access in some unforeseen situations. The Fund needs to maintain the flexibility to provide exceptional access in situations that cannot be foreseen, even though any such use is expected to be very rare. As above, in all cases the principles for exceptional access listed in paragraph 13 would be applied, as well as the procedures and information requirements set out in the framework.

B. Experience with the Four Criteria, Early Board Involvement, and Increased Burden of Proof

17. **With only the experience of the special cases of Argentina and Brazil it is too early to reach definitive judgments about the usefulness of the four criteria, and staff does not propose any changes in the definition of the criteria at this point.** In staff's view, the evaluation of the four criteria has added a helpful structure for the staff, management, and the Board in making judgments on exceptional access. However, in the very different cases of Argentina and Brazil, since neither country was in the throes of a capital account crisis at the time exceptional access was considered, the judgments turned less on whether the criteria were fulfilled, and more on whether exceptional access should be provided even though some criteria were not fulfilled.

18. **As called for under the exceptional access policy, there was early and active Board involvement in the period leading up to the formal Board discussions on Argentina and Brazil.** The Board met three times in informal sessions in the run-up to the approval of Argentina's arrangement on September 20, 2003, and twice in the run-up to the approval of Brazil's augmentation on December 12, 2003 (Table 2). The exceptional access framework calls for at least one such meeting. A concise staff statement was circulated in advance of each of these informal sessions, in most cases with a circulation period greater than the minimum two hours. There were also several other formal meetings on each country around the same time (e.g., reviews under the arrangements in place).

Table 2. Formal and Informal Board Meetings, and Documents Related to Exceptional Access for Argentina and Brazil, 2003.

Date	Meeting	Documents
Argentina		
July 28	Third Review under the SBA	Staff report (EBS/03/108, 7/18/03)
July 30	Informal Restricted Meeting	"Statement by the Staff Representative on Exceptional Access for Argentina Informal Board Meeting" (FO/DIS/03/78, 7/29/03)
August 21	Informal Restricted Meeting	
August 27	Financing Assurances Review	Staff report (EBS/03/123, 8/22/03)
September 3	Informal Restricted Meeting	"Statement by the Staff Representative on Exceptional Access for Argentina Informal Board Meeting" (FO/DIS/03/92, 9/2/03)
September 10	Informal Restricted Meeting	
September 20	Request for Stand-By Arrangement (in Dubai)	Staff report (EBS/03/130, 9/15/03, Supplement 1); Assessment of the Risks to the Fund and the Fund's Liquidity Position (EBS/03/130, 9/15/03, Supplement 2); and Report on Exceptional Access, EBS/03/130, 9/16/03, Supplement 3).
Brazil		
September 5	Fourth Review under SBA	Staff report (EBS/03/123, 8/25/03)
October 22	Informal restricted meeting	"Statement by the Staff Representative on Exceptional Access for Brazil Informal Board Meeting" (FO/DIS/03/108, 10/21/03)
November 4	Informal restricted meeting	"Statement by the Staff Representative on Exceptional Access for Brazil Informal Board Meeting" (FO/DIS/03/114, Rev. 1, 11/4/03)
December 12	Fifth Review Under the Stand-By Arrangement and Requests for Extension and Augmentation of the Arrangement and Extension of Repurchase Expectations	Staff report (EBS/03/157, 11/24/03) (Annex I of the report contains an assessment of exceptional access); Assessment of the Risks to the Fund and the Fund's Liquidity Position (EBS/03/157, Supplement 2, 11/24/03).

Source: Secretary's Department.

19. **Staff believes that the experience with the procedures for early Board involvement has been positive.** This involvement allowed all Directors to be kept informed of the negotiations and to express concerns early on. The informal meetings also provided a mechanism for staff to hear informal views of Directors on key aspects of the program. In the run-up to the decision on Argentina, and following the second informal meeting, several Directors raised concerns with staff and management over the planned phasing of access in the proposed arrangement—a concern that was eventually reflected in a less frontloaded phasing. In Brazil's case, the meetings gave management and staff an opportunity to discuss with the Board a number of important issues, notably the terms of the financing. Care will continue to be needed to ensure that the flexibility and discretion required by management and staff are protected in coming to an agreement on a program.

20. **The Board was provided with additional information and documentation in the exceptional access requests for Argentina and Brazil.** This comprised:

- A detailed justification of access, comparison of the access proposal with alternative metrics aside from quota, a more rigorous analysis of capacity to repay, including debt to the Fund as a share of total debt, and, as noted, debt sustainability analysis.

- A separate report evaluating the case for exceptional access based on further consideration of the four substantive criteria. The policy foresaw the possibility that this report could be circulated to the Board ahead of the other staff documents where time permits, and in all cases it would be included in the program documents. In the event, for both Argentina and Brazil this report was circulated at the time of the other staff documents.

- A report assessing the risks to the Fund and the Fund's liquidity position resulting from the proposed exceptional access. In the case of Argentina, this report highlighted the risks to the Fund from the substantial exposure to Argentina and stressed that these risks are affected principally by the willingness and capacity of the government to implement the program. It also underlined the risks associated with the limited definition of policies and the adjustment contained in the program, and Argentina's decision to fall temporarily into arrears with the Fund. In the case of Brazil, the report noted that there were risks associated with the Fund's very large exposure to the country, notwithstanding Brazil's good program implementation and strong payments record. The paper also stressed that augmentation of the SBA and extension of repurchase expectations implied that Brazil will continue to have access to relatively cheap Fund financing for longer, especially since the augmentation was on credit tranche rather than SRF terms.

21. **The staff documents for the September 2003 decision on a stand-by arrangement for Argentina have been published, although consent from the authorities for publication of the staff documents for the first and second reviews is pending. Brazil has not consented to publication of the staff reports, although it has published the Letter of Intent.** There is a high premium on increasing public understanding of the program strategy, and thus its credibility. Consistent with this, the Executive Board strengthened the Fund's policy on publication of exceptional access staff documents. In particular, "the Managing Director will generally not recommend that the Executive Board approve a request to use Fund resources that would result in the relevant member obtaining exceptional access to the Fund's general resources, unless that member consents to the publication of the

associated staff report."[11] This policy will apply to requests for new arrangements or changes in access under existing arrangements from July 1, 2004.

C. The Presumption to Use the Supplemental Reserve Facility

22. **In March 2003, the Board strengthened the presumption that exceptional access in capital account crises should be provided under the SRF**.[12] This presumption was adopted to help ensure Fund resources revolve quickly and to render transparent financial risks to the Fund associated with exceptional access. At the same time, there will continue to be capital account crises, for instance where the balance of payments will be expected to recover more slowly, and where the SRF terms, in particular its maturity, will not be appropriate.

23. **SRF resources were not used in Argentina or Brazil because neither Argentina nor Brazil met the strict circumstances test established in the SRF decision,** namely that:

> "The Fund will be prepared to provide financial assistance in accordance with the terms of this section to a member that is experiencing exceptional balance of payments difficulties due to a large short-term financing need resulting from a sudden and disruptive loss of market confidence reflected in pressure on the capital account and the member's reserves, if there is a reasonable expectation that the implementation of strong adjustment policies and adequate financing will result, within a short period of time, in an early correction of such difficulties."[13]

Argentina's balance of payments need related to an earlier capital account crisis, but the member was no longer experiencing pressures that would justify use of the SRF, and credit tranche resources were used. Brazil's request for a precautionary extension recognized that its need was potential rather than actual, as required under the SRF.[14]

24. **Argentina's stand-by arrangement raises unusual risks for the Fund.** The staff's assessment noted that the substantial exposure of the Fund entailed significant risks. These risks are affected principally by the willingness and capacity of the government to implement

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[11] See "The Fund's Transparency Policy—Issues and Next Steps—Amendments to the Transparency Policy Decision" (SM/04/39, 2/12/04).

[12] See BUFF/03/28, 3/5/03.

[13] Decision No. 11627-(97/123) SRF, December 17, 1997.

[14] A member with an existing balance of payments need consistent with the SRF requirement may use that facility, and may decide not to draw, as in the case of Brazil's use of the SRF in 2001.

key reforms, crucial for sustainability. While Argentina's purchases in the credit tranches are subject to the maximum surcharge of 200 basis points over the normal rate of charge, this is lower than the range of surcharges applying under the SRF (300-500 basis points). The maturity of drawings under the credit tranches, with obligations falling due at 3¼-5 years is also up to two years longer than under the SRF. At the same time, the nature of Argentina's balance of payments need, with repayment capacity depending on, among other things, a sustainable solution to its debt problem, would make the SRF terms, in particular the repurchase schedule, inappropriate.

25. **Many Directors would have preferred SRF resources to be used in the context of Brazil's precautionary augmentation.** While Brazil did not have an actual balance of payments need, it was recognized that if one arose it would be likely to be the sort envisaged in the SRF. The June 2003 staff paper on precautionary arrangements proposed modifying the SRF to allow its resources to be committed in precautionary settings, when the potential need relates to vulnerability to a capital account shock. The higher SRF charges would help discourage members from using exceptional access longer than necessary. The proposal was made in the context of a package of reforms to adapt precautionary arrangements for crisis intervention, but for which there was no broad support at the Board at that time. Most recently, in discussing the financial risks faced by the Fund in light of large exposures and increased concentration in credit, Directors noted the importance for Fund policies on access to include incentives for members to repay the Fund as their balance of payments improves, including the presumption that exceptional access will be on SRF terms.[15] This issue will be taken up in the forthcoming paper on precautionary arrangements.

26. **Should the SRF be used more broadly, perhaps in all arrangements with exceptional access?** Exceptional access tends to increase the concentration of the Fund's exposure and the risks the Fund faces. Given these additional risks, and the need to increase the Fund's precautionary reserves, Directors have suggested that there be a presumption of using SRF resources for any exceptional access.[16] It is not clear that the SRF can or should be used in all cases, and such a presumption should still leave room for consideration of those cases when exceptional access should be on credit tranche terms.

27. **The SRF may not be an appropriate facility for use when the balance of payments problem is likely to be of a more medium-term nature**, and indeed such use would be inconsistent with the terms of the facility. For instance, there are some cases where the SRF-supported strategy did not succeed as quickly as hoped for, and the Fund may decide to finance a follow-on program where balance of payments prospects require using longer-

[15] See "The Acting Chair's Summing Up, Financial Risk in the Fund and the Level of Precautionary Balances" (BUFF/04/35, 3/2/04).

[16] See BUFF/04/35, 3/2/04

maturity credit tranche resources. In some capital account crises, capital may return quickly once the Fund-supported program helps restore confidence in the authorities' policies and rebuild reserves. In those cases, SRF resources would be appropriate. In other crises cases, for example those associated with portfolio shifts that are unlikely to be reversed, recovery through the capital account is likely to be relatively slow.[17] In such cases, the SRF terms, particularly its short maturity, could affect the speed at which market confidence returns. The current arrangements with Argentina, Brazil, Turkey, and Uruguay all reflect this.

III. CIRCUMSTANCES OF REPURCHASES OF EXCEPTIONAL ACCESS

28. **The new framework is designed to increase the chance that exceptional access is used in support of a strategy that leads to a quick turnaround and repayment.** However, there will continue to be situations where the risks are difficult to assess, or where our initial assessment is overtaken by events. There will also be situations where it is clear from the outset that the balance of payments problem may take longer to resolve. Thus, there will continue to be some cases where the Fund cannot be repaid as quickly as first expected. In this regard, Directors have highlighted the importance of attaining greater clarity on the strategies and circumstances to reduce high levels of outstanding Fund credit in the countries that have benefited from exceptional access.

A. Current Levels of Exposure

29. **Increases in the level and concentration of Fund credit outstanding since the mid-1990s are related to the financing needs of those emerging market countries that have experienced difficulty in maintaining capital market access** (Figure 1).[18] While the growth of private international capital markets has facilitated investment-led growth, sudden stops in private capital flows or their reversal have contributed to sizeable gross financing requirements in some countries. The Fund has supported members' balance of payments adjustment and very large financing requirements, and the concentration of Fund credit has increased markedly since Mexico's SBA in 1995. Nevertheless, the current level of outstanding Fund credit—as measured against the size of world trade or world GDP—is still below its peak in the 1980s.

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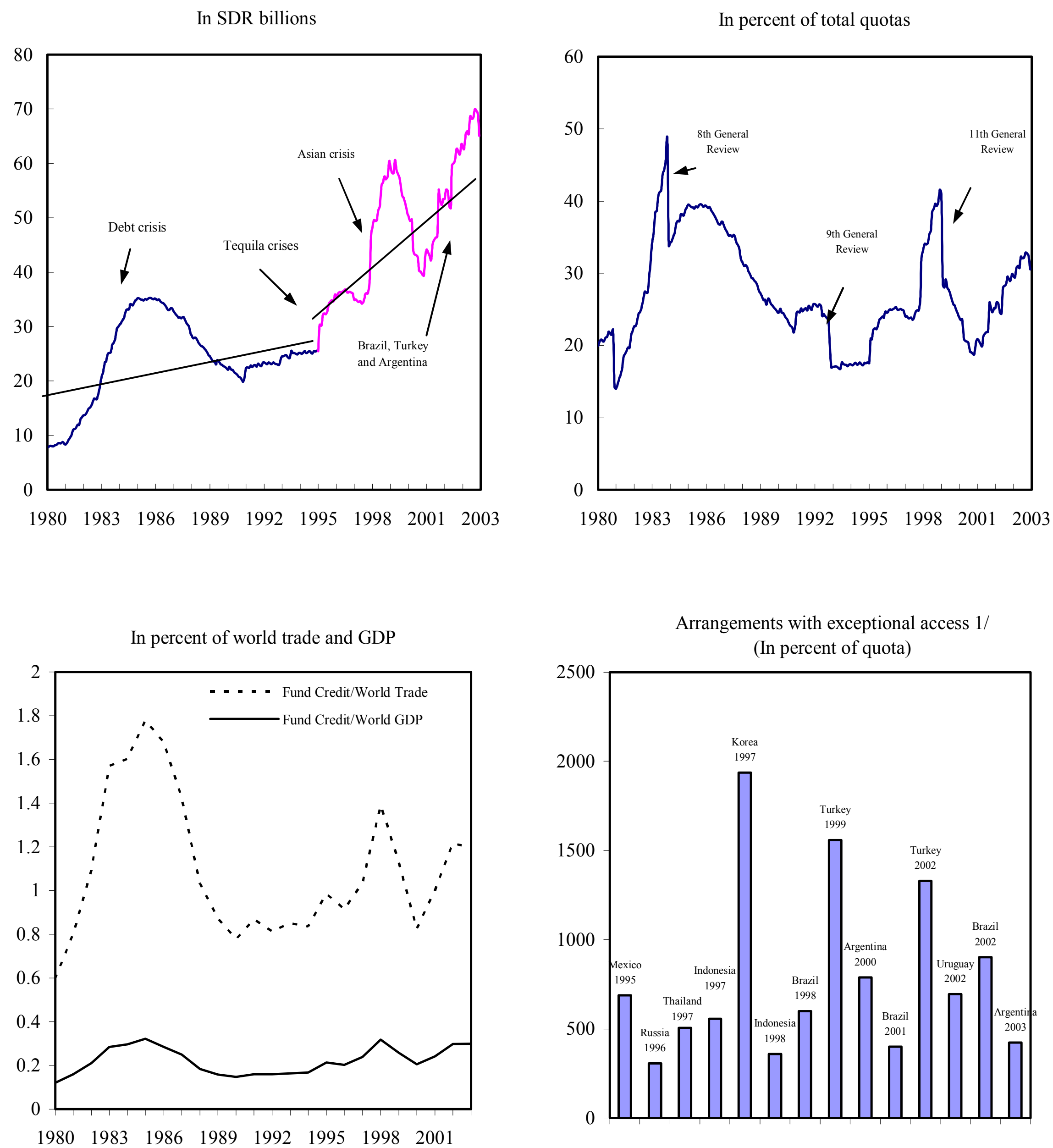
[17] Examples of portfolio shifts that are unlikely to be unwound include the unwinding of carry trades associated with a shift from fixed to flexible exchange rates in Thailand (1997), Russia (1998), Brazil (1998) and Turkey (2001); and a shift in the behavior of domestic banks to prevent excessive exposure to risk associated with concentration of claims on government in banks' assets (e.g., Russia, 1998) and (Turkey, 2001).

[18] See also "Financial Risk in the Fund and the Level of Precautionary Balance" (EBS/04/11, 2/4/2004).

Figure 1: Developments in Fund Credit in the GRA, 1980-2003



Source: IMF Finance Department.

1/ Based on quota at the approval. Augmentations are included in the initial arrangements.

30. **The exceptional access arrangements approved for six members during the 1990s have been completely or largely repaid, consistent with the revolving nature of Fund resources** (Figure 2).[19] Only Indonesia's outstanding Fund credit still exceeds the cumulative access limit of 300 percent of quota, but it is scheduled to drop below that level during 2004 in the context of post-program monitoring. Excluding Brazil (1998) where access never exceeded the cumulative limit, for the other cases the time above the cumulative exceptional access limit has averaged two years.

31. **All exceptional access arrangements approved since 2000 (Brazil, Turkey, Argentina and Uruguay) are, on current schedules, at or near their respective peaks of Fund credit outstanding**. Even if Brazil makes no further purchases under its now precautionary arrangement and these four members repurchase on the expectations schedule, the time above the cumulative access limit will average nearly six years.

32. **The concentration of credit risk and the long period during which high access remains outstanding have at least two implications**. First, longer-term use of Fund resources at high access levels slows the rate at which Fund resources revolve and could, in a tight liquidity situation, constrain access for other potential users of Fund resources.[20] Second, the higher financial risk to the Fund requires higher levels of precautionary balances. The Board's decision in 2002, reaffirmed in 2004, to double the target for precautionary balances was based on the recognition that credit risk to the Fund now derives primarily from exceptional access arrangements with middle-income countries.

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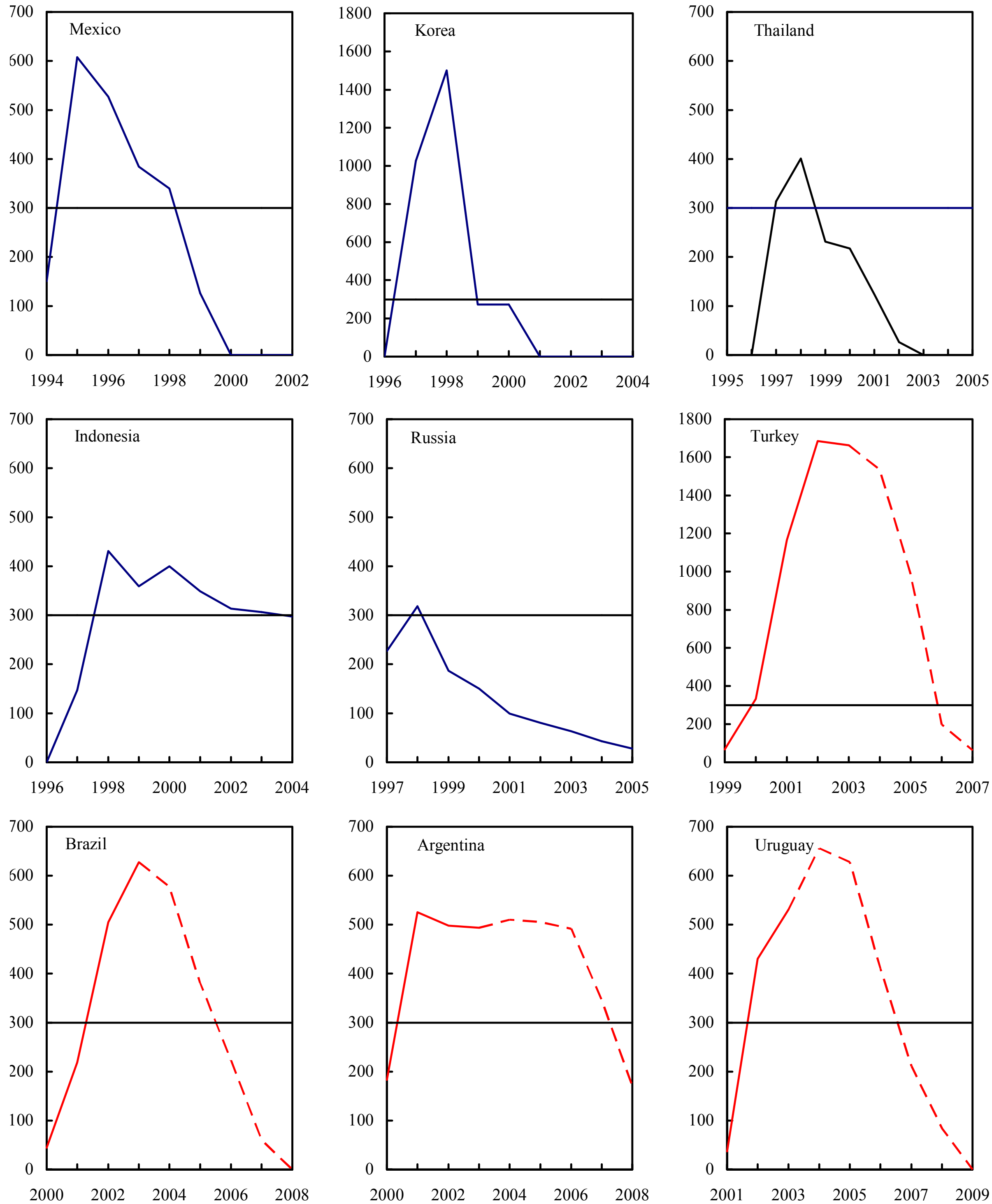
[19] Early repayments were made in three cases (Mexico, Korea and Thailand). The Brazil arrangement, approved in 1998, was largely repaid (with SRF resources repaid early), before a new arrangement was approved in 2001.

[20] See Table 1 in "Argentina—Assessment of Risks to the Fund and the Fund's Liquidity Position" (EBS/03/13, 9/15/2003, Supplement 2) and "Brazil—Assessment of Risks to the Fund and the Fund's Liquidity Position" (EBS/03/157, 11/24/03, Supplement 1). Argentina is a long-term user of Fund resources and by end-2004 Brazil will have had an arrangement for six years, one less than the benchmark for long-term engagement. See "Acting Chair's Summing-Up, Conclusions of the Task Force on Prolonged Use of Fund Resources" (BUFF/03/51, 4/8/03). The extension of repurchase expectations in these two cases will further slow the speed at which Fund resources revolve although they do not affect directly the Fund's Forward Commitment Capacity (FCC). The calculation of the FCC assumes that repurchases would be made on an expectations basis for SRF resources, and on an obligations basis under all other facilities.

Figure 2. Capital Account Crises: Fund Credit Outstanding as a Share of Quota 1/
(From crisis minus one year to crisis plus seven years)



Source: IMF, *International Financial Statistics* .

1/ Countries with present arrangements (Turkey, Brazil, Argentina and Uruguay) are assumed to make remaining purchases under arrangements (unless precautionary) and to repay at expectation if not already extended.

B. Repurchases in Past Exceptional Access Cases

33. **The reduction in exposures to the Fund of earlier uses of exceptional access provides a context in which to evaluate the adjustment strategy of current high access cases.** In principle, balance of payments viability is restored through some combination of an increase in savings-investment balances (public, private, or both) and a restoration of market access that together generates the foreign exchange reserves necessary for Fund repurchases.

34. **In Korea, Thailand and Indonesia nearly the entire improvement in the balance of payments came from an improvement in private savings-investment balances** (Figure 3 and Tables 3 and 4). These adjustments were associated with sharp depreciations of the exchange rate, which depressed demand and led to substantial import compression. Conversely, the fiscal deficit widened, contributing negatively to adjustment, as fiscal policies were relaxed to provide some support to economic activity in the midst of sharp recessions, and reflecting the costs of banking crises. In all these cases, the extent of aggregate adjustment far exceeded projections made at the time of program approval.[21]

35. **In Russia, both the improvement in private and public savings-investment balances were significant.** This reflected the debt default as well as the devaluation, followed by a fortuitous rise in the oil price and a major fiscal adjustment conducted outside a Fund arrangement (reflecting in part the loss of market access). Thus, Russia's current account also improved strongly, although the nature of adjustment was quite different from the Asian countries.

36. **Despite the improvement in the current account, the ability to replenish gross reserves—and hence the pace of repurchases—has tended to hinge on the behavior of the capital account.** Where capital outflows moderate or rebound quickly after the crisis, as in the case of Korea, and enable gross reserve accumulation, repayment to the Fund tends to be speedy. Where confidence fails to recover, and net capital outflows continue, as in Indonesia and Thailand, the scope for reserve build-up is more limited and Fund repurchases are more difficult.[22] In Russia, continuing net capital outflows were more than outweighed by the boom in oil exports, although neither the strength of the current account or continued weakness of the capital account was accurately foreseen at the time the arrangement (and the augmentation) was approved.

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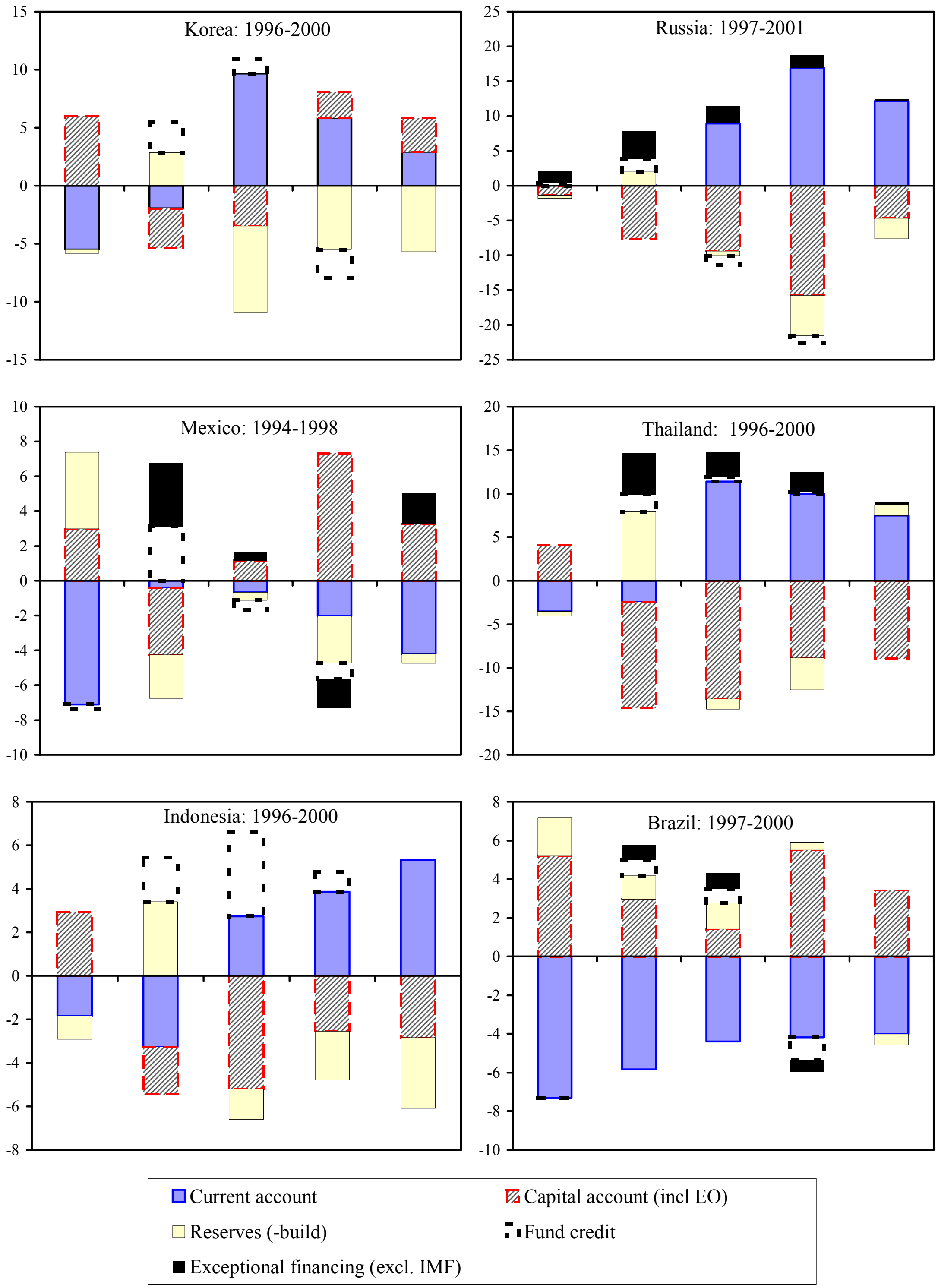
[21] See *IMF-Supported Programs in Capital Account Crises*, Occasional Paper 210, 2002, IMF.

[22] Market confidence is of course not exogenous, and the monetary and foreign exchange market intervention policies (and others) of the authorities, as well as the extent of exchange rate overshooting, will play an important role in determining market expectations and private capital flows.

Figure 3. Past Exceptional Access Arrangements: Balance of Payments Financing
(In percent of average GDP, crisis-1 to crisis+3)



Source: IMF, *International Financial Statistics.*

Table 3. Factors Contributing to Repayment of Fund Credit

	Cumulative Balance of Payments Financing Contribution			Change in Gross Reserves (In $ billions) 1/		Indicators of Fund Credit	
	Current Account	Capital Account	Type Debt Restructuring	Initial projection.	Actual	Arrangement approval to peak credit outstanding (no of months)	Repay 75 percent of peak credit (no. of months)
Mexico (1995)	**Positive from T-1; Negative thereafter** (higher exports and imports than projected)	**Positive from T+2** Private Sector FDI and portfolio equity flows	**None**	15.4	29.3	10	50
Thailand (1997)	**Positive from T+1** Import Compression	**Negative** Continuing drains from banks and other private sector	**Voluntary bank credit rollover**	23.0	10.6	22	38
Indonesia (1997)	**Positive from T+2** Import compression	**Negative** Continuing drains from banks, other private sector, and portfolio equity. FDI negative from T+2	**External bank credit & corporate debt restructuring**	9.0	6.4	39	n.a.
Korea (1997)	**Positive from T+1** Import compression	**Slightly Negative** Improving FDI & Portfolio equity .from t+2	**External bank credit restructuring**	47.3	93.9	11	27
Russia (1998)	**Positive from T+1** Oil exports & Import compression	**Negative** All major categories negative except FDI	**Sovereign domestic debt default**	22.2	78.2	...	65
Brazil (1998)	**Negative** Gradual narrowing of current account deficit T to T+4	**Positive** Private sector FDI and portfolio equity. But lower than anticipated	**Voluntary commercial bank credit rollover**	27.4	5.3	4	12

Source: International Financial Statistics; "IMF-Supported Program in Capital Account Crises," IMF Occasional Paper No. 210, 2002.

1/ Program projections of the change in gross reserves between approval of program and repayment.

37. **By contrast, in Brazil the adjustment in savings-investment balances was negative.** Brazil, like Mexico, benefited from a rapid restoration of confidence and continued market access, which allowed it to continue to run current account deficits and make Fund repurchases.[23] At the same time, the build-up in reserves fell short of what had been anticipated when the arrangement was approved and, together with remaining external imbalances, contributed to renewed vulnerabilities and the need for a subsequent Fund arrangement in 2002.

38. **Where capital flows provided a net source of foreign exchange, private sector non-debt-creating flows (portfolio investment and FDI) tended to be more important than debt-creating flows** (Figure 4). Moreover, in countries experiencing a banking crisis, possibly associated with pervasive corporate or financial balance sheet weaknesses (Thailand, Korea, Russia and to a lesser extent Indonesia), banks and other private sector capital flows have generally been a significant foreign exchange drain for years after the crisis. The crisis

[23] It is notable that FDI increased following the devaluation.

Table 4: Domestic Savings-Investment Adjustment in Exceptional Access Cases 1/
(In percent of GDP)

	Gross program access at approval	Change in domestic savings-investment balance				Actual exchange rate change (percent)
		Program Projection	Actual			
			Total	Public sector	Private sector	
Past Cases						
Mexico (1995)	6.3	5.3	5.1	-1.0	6.2	57
Thailand (1997)	2.6	4.7	18.1	-4.3	22.5	33
Korea (1997)	4.4	4.3	10.4	-4.7	15.2	32
Indonesia (1997)	4.6	1.3	7.5	-2.7	10.2	70
Russia (1998) 2/ 3/	5.7	-2.0	17.9	10.7	7.2	79
Brazil (1998)	2.0	0.5	-0.3	0.7	-0.9	41
Current Cases						
Argentina (2001) 2/	5.5	0.3	9.3	4.5	4.8	66
Turkey (2001) 2/	9.6	4.2	2.0	1.3	0.7	59
Brazil (2002)	6.3	1.2	4.0	0.9	3.1	41
Uruguay (2002) 2/	16.5	1.2	3.5	0.8	2.7	57

Sources: IMF, *International Financial Statistics*; and various country staff reports.

1/ All changes are from the year before the crisis (t-1) to two years after the crisis (t+2), thus capturing the bulk of the period in which balance of payments recovery is to take place. For current high access cases based on latest estimates/projections in staff reports.
2/ Includes amounts remaining to be drawn from initial approval as well as new augmentations approved.
3/ Includes 50 percent of quota approved under the CCFF.

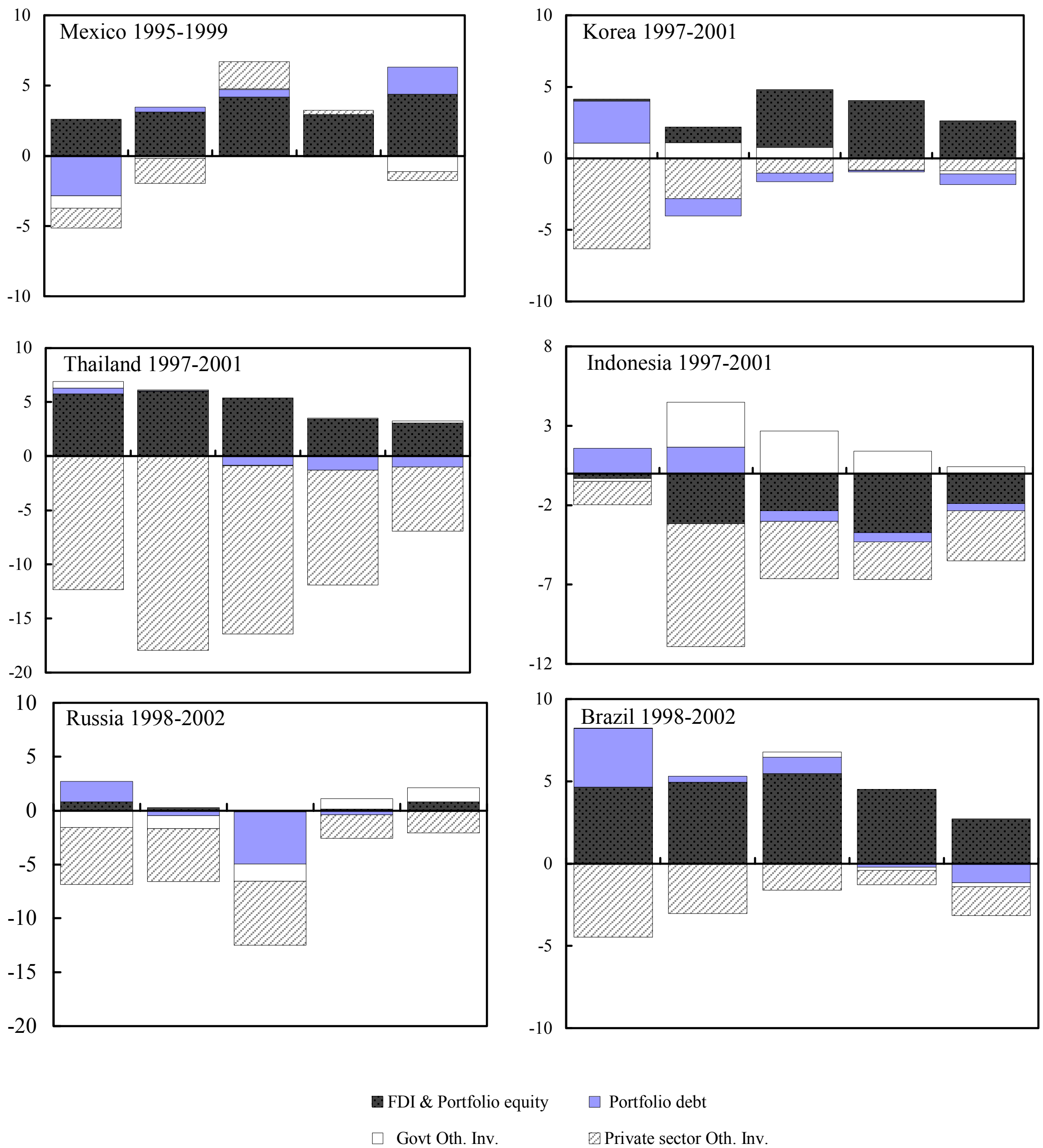
triggered a reassessment of risks and rebalancing of investor's portfolios that has not quickly reversed.[24]

39. **In several instances, efforts to take pressure off the capital account were supported by voluntary rollover or restructuring agreements.** In Indonesia and Korea, agreements were reached with foreign banks to exchange existing interbank credit lines into new short- to medium-term instruments, while in Russia sovereign debt was restructured into somewhat longer maturities.[25] Thailand and Brazil encouraged, with various degrees of intensity, banks to roll over their credit lines but did not engage in formal restructuring

[24] In the Asian countries, as well as Russia and Brazil, short term "carry trade" inflows were withdrawn and did not return. (Carry trade here refers to the practice of borrowing at low interest rates in major currencies to increase exposure in emerging market currencies.)

[25] In Korea and Indonesia the extension of maturities was facilitated by a government guarantee for payments on the newly issued instruments of debtor banks, as well as some moral suasion by supervisory authorities on creditor banks to participate in the debt exchange. The efforts undertaken in Indonesia to restructure corporate debt took place through direct negotiations between debtors and creditors, including the use of a government-sponsored forum to mediate discussions.

Figure 4. Past Crises: Capital Account Flows
(In percent of average GDP t to t+4)



Source: IFS, *International Financial Statistics* .

C. Strategies in Place for Repaying Exceptional Access in Current Cases

40. **A realistic assessment of the capacity to repay in current exceptional access cases requires a close analysis of the assumptions underlying the balance of payments projections**, as well as the underlying reforms and arrangements in place to generate the resources for Fund repurchases. Table 5 highlights the magnitude of repurchases projected for selected current access cases, against several key metrics.

Table 5. Capacity to Repay Indicators for Selected Current High Access Cases
Scheduled repurchases and charges

	2003	2004	2005	2006	2007	2008	2009
Argentina (EBS/04/5, Supplement 1) 1/							
Billions of SDR	4.6	4.1	2.6	1.9	3.6	3.9	2.3
In percent of exports	19.6	18.0	10.6	7.4	13.4	14.1	8.0
In percent of gross international reserves 2/	45.5	37.5	22.3	15.1	30.0	33.6	20.2
Turkey (EBS/03/148) 1/							
Billions of SDR	1.9	3.8	5.6	7.9	1.3	0.6	0.0
In percent of exports	3.9	7.0	9.3	12.2	1.8	0.8	0.0
In percent of gross international reserves 2/	8.1	17.3	29.4	52.7	7.6	2.9	0.0
Uruguay (EBS/04/17) 1/							
Billions of SDR	0.1	0.2	0.3	0.7	0.6	0.4	0.2
In percent of exports	4.8	8.8	12.9	29.4	24.7	14.8	8.5
In percent of gross international reserves 2/	6.9	10.3	15.5	38.6	33.8	23.6	13.8

Source: Staff Reports.

1/ Data as reported in staff reports. SRF repurchases are on expectations schedule, unless they have already been converted to an obligations schedule. Treatment of credit tranche resources is as reported in the Staff Report, expectations for Turkey and obligations for Argentina and Uruguay.
2/ Projections of reserves for the end of the same year.

41. **Some features of the current exceptional access cases distinguish them from the previous high access cases:**

- **Initial sovereign debt levels are higher.** Argentina's medium-term balance of payments viability hinges significantly on the ability to restructure its debt in a sustainable manner. In Uruguay, Brazil, and Turkey, high debt levels will continue to generate large gross financing requirements, and hence considerable vulnerability to shocks or spells of market drought. Moreover, the interplay between exchange rate depreciations, public debt dynamics, and financial sector vulnerabilities is more unstable than in earlier cases (see for instance the high degree of dollarization in Uruguay).

- **Managing the difficult debt dynamics will require sustained primary surpluses into the medium term.** Contrary to most of the earlier exceptional access cases (where fiscal policy could be relaxed in the face of declining domestic demand), the current arrangements require a tight fiscal policy to consolidate debt dynamics.

- **Three of the more recent crises (Argentina, Turkey and Uruguay) were associated with large-scale deposit runs and banking crises**, whereas the banking crises in the earlier exceptional cases were less severe (only Indonesia experienced serious bank runs).[26] Bank crises have tended to add to the fiscal costs and to the volatility of capital flows, and have delayed a restoration of confidence.

- **Members with current arrangements have on average been much less open to trade at the outset of the crisis**, lessening the scope for current account adjustment, and placing a greater importance on restoring capital inflows. Exports in the five early cases were twice as large in relation to GDP as in the four current arrangements (with Turkey the notable exception, see Figure 5).

- **Outstanding use of Fund resources has generally been higher at the outset of the arrangement**. Contrary to previous arrangements where no, or relatively little, Fund credit had been outstanding, current high access cases had much higher levels of Fund credit outstanding when the exceptional access was approved.

- **In contrast to the arrangements for Mexico, the Asian countries, and Brazil (1998), co-financing from other multilateral or bilateral sources has been small or non-existent in the recent arrangements** (the availability of this co-financing in earlier cases varied, with it sometimes being provided in parallel and sometimes as a "second line of defense"). Nevertheless, the Fund's share in countries' gross financing requirements has been roughly unchanged—22 percent on average in the early cases compared to 25 percent in the more recent cases.[27] However, the Fund's share in external debt is higher in recent cases.[28]

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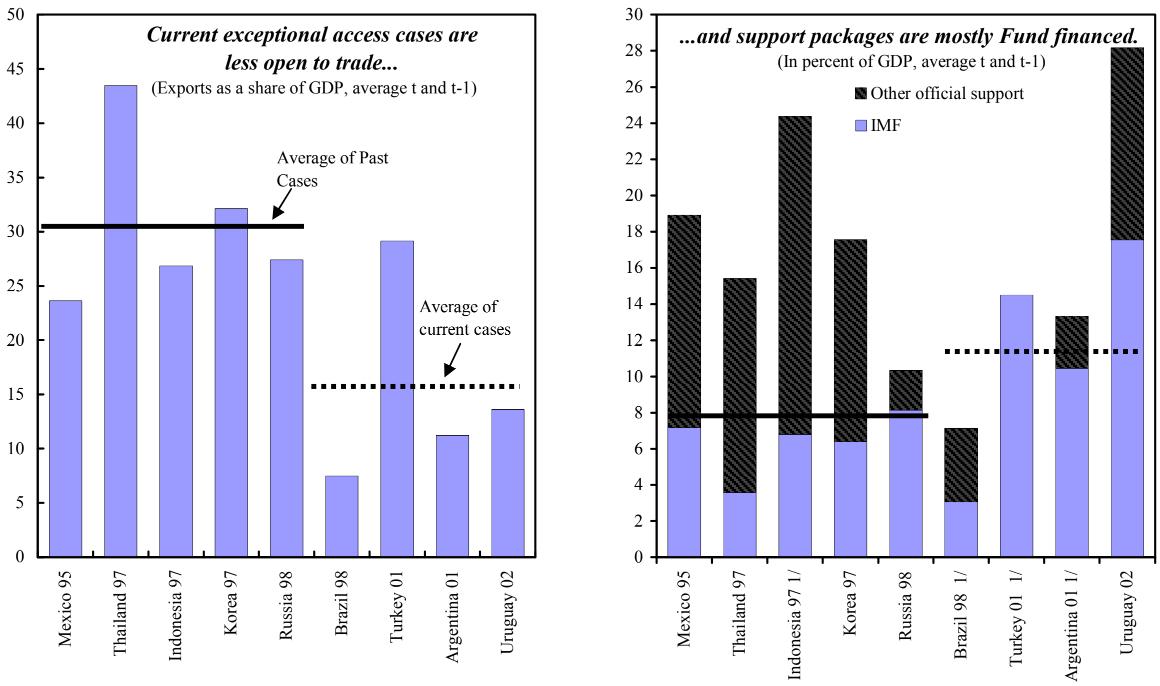
[26] While there were no deposit runs in Korea and Thailand, there were substantial withdrawals of foreign credit lines, which led to the closure of most of the finance companies and merchant banks, and public intervention in some commercial banks.

[27] The latter average excludes Uruguay, where the gross financing requirement numbers are somewhat distorted due to the nature of the crisis.

[28] See "Financial Risk in the Fund and the Level of Precautionary Balances" (EBS/04/11, 2/4/2004).

Figure 5. Capital Account Crises: Openness and Financing Packages



Sources: IMF, *International Financial Statistics* and staff estimates.

1/ Excludes successor arrangements from the IMF.

42. **The original program strategy in the current exceptional access cases was in many respects similar to the earlier ones.** That is, the sustained implementation of structural and fiscal reforms into the medium term was assumed to lead to a modest improvement in the current account (Turkey's improvement was more substantial), an improvement in debt dynamics and, as confidence would take hold, a recovery of the capital account. The reduction in savings-investment imbalances combined with an improved investment climate was expected to allow these countries to attract continued foreign investment, and allow a gradual rebuilding of reserves to meet large Fund repurchase obligations over the medium term.

43. **The programs in Argentina, Brazil (2001), Turkey and Uruguay were not initially successful in restoring market confidence, leading to requests from the authorities for augmentations in access to Fund resources, extensions of repurchase expectations, or both.** In Turkey, a banking sector crisis followed by an unsuccessful defense of the crawling peg regime increased financing requirements and worsened the government's debt position, while political instability delayed a return of confidence. In Uruguay, initial attempts to restore confidence in the financial sector failed, and the

continuing capital flight ultimately depleted reserves and brought down the exchange rate. This caused substantial damage to government, financial, and corporate balance sheets. Brazil's augmentation in 2003 took place in a somewhat different context, following a successful program, but was aimed at overcoming a period of more tenuous market access, and allowing the authorities to exit from Fund assistance. Setbacks were also experienced in previous high access cases, but they generally did not lead to augmentations.[29]

44. **In response to these setbacks, the authorities' programs have generally been strengthened.** They have targeted additional fiscal and current account adjustment, and are addressing underlying structural weaknesses, mainly in the fiscal and financial sector. In the case of Uruguay and Argentina, a formal restructuring of sovereign debt is a vital element in the revised program strategy to restore medium-term balance of payments viability, and secure future market access (Uruguay completed its debt exchange in 2003 and has already regained a degree of market access, as discussed below).

45. **Provided implementation proceeds as programmed and market conditions remain broadly favorable, these countries remain on track to make repurchases as scheduled (Figure 6).** Brazil and Uruguay are assumed to benefit primarily from FDI and portfolio inflows, while the Turkey program assumes a return of external financing to the corporate and banking sectors. For Argentina, the generation of foreign exchange reserves is predicated on its ability to continue to run significant current account surpluses, while exceptional debt relief should take some pressure off the capital account. Of these countries, Brazil and Turkey are projected to make net repayments to the Fund in 2004. The strategy in the four cases is discussed in more depth below.

Turkey[30]

46. **Turkey's capacity to repay the Fund is premised on continued net private capital**

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[29] Indonesia's arrangement is the only one to have been augmented—Mexico's and Thailand's arrangements were not augmented, Russia's arrangement was not augmented following its default, and Korea's arrangement was rephased but not augmented.

[30] Turkey's exceptional access began with the December 1999 arrangement with access at 300 percent of quota. Fund credit was intended to bolster reserves and strengthen credibility in the crawling peg and the disinflation strategy. In the event, reserves were severely depleted as a result of liquidity injections during a banking crisis and a failed defense of the exchange rate peg. The arrangement was twice augmented in 2001 following banking and currency crises. SRF obligations were repaid in 2002 in the context of a new SBA. After May 2001, Fund credit helped to facilitate the rollover of government debt, thereby helping to reduce interest rates from elevated levels at the time of the currency float. At end-2003, Fund credit outstanding amounted to SDR 16.2 billion (US$22.7 billion), equivalent to 1,680 percent of quota, 71 percent of gross reserves, 37 percent of exports, and 10 percent of GNP.

inflows and a sustained strengthening of the fiscal position. Net capital inflows are expected to strengthen as resident capital returns, non-resident demand for lira-denominated assets increases, and structural reforms lead to increased non-debt creating inflows. Such inflows allowed the CBT to purchase nearly US$10 billion in foreign exchange reserves in 2003. The maintenance of high primary fiscal surpluses (6½ percent of GNP) will contribute further to recovery, as real interest rates and the public sector borrowing requirement decline, thereby enabling a progressive mobilization of predominantly domestic market financing, which in effect will substitute for the government's current reliance on Fund financing (Box 3 discusses the institutional arrangements surrounding Fund credit). To prevent a dramatic reduction in net reserves as payments to the Fund fall due, continuing capital inflows will allow CBT to buy foreign exchange, sterilized as necessary to achieve inflation objectives. Utilization of available U.S. financing could also strengthen reserve cushions ahead.

47. **Turkey has recently started to make net repayments to the Fund**. While the expected flows of funds needed to enable repayment are in train, they will need to be sustained until 2007 for the bulk of Fund credit to be repaid.

Brazil [31]

48. **Brazil's external vulnerability and external financing requirements have been much reduced through the turnaround in the current account, combined with a favorable external environment for emerging markets**. Nevertheless, gross external financing requirements are expected to increase gradually as the current account moves back into deficit, and should remain among the highest among the emerging markets for the foreseeable future.

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[31] The Fund has approved exceptional access for Brazil on three occasions in the last three years. On September 14, 2001, in the midst of the Argentine crisis and in the aftermath of the events of September 11, 2001, the Board approved a 15-month SBA for Brazil (access was SDR 12.1 billion, or 400 percent of quota). Market pressures intensified in 2002 in the run-up to the Presidential elections in November/December of that year. The Board approved another 15-month SBA with exceptional access (740 percent of quota in total) on September 6, 2002 to support the continuity of appropriate macroeconomic policies during political transition and extended and augmented it in December 2003, as part of an explicit exit strategy for Brazil. Fund exposure at end-2003 stood at SDR19 billion (US$28.5 billion), equivalent to 628 percent of quota, 58 percent of gross reserves, 37 percent of exports, and 6 percent of GDP.

Box 3. Institutional Arrangements for Use of Fund Resources: Argentina and Turkey

Under the arrangements with Turkey and Argentina (under the 2001 SBA), Fund resources have been managed directly by the government and effectively used as a source of budget financing to address a key source of balance of payments need. This is in contrast to other cases, where Fund resources provided to a country have been retained by the central bank and used for purposes such as intervention or bolstering reserves. This box explores the implications of arrangements such as those found in Argentina and Turkey.

From an *economic* perspective, the Fund's balance of payments financing relieves a need for the economy as a whole whether it is retained by the central bank or effectively used as a source of budget financing.1/ From a *legal* perspective, the particular entity in the country that receives Fund purchases or effects the ultimate transfer of repurchases to the Fund has no relevance with respect to who is indebted to the Fund. Rather, under the Fund's Articles, financing is provided in all cases *to member countries* (albeit through their designated fiscal agents which is oftentimes the central bank). Similarly, the related repurchase liability is in all cases an obligation *of the member*, as represented by its government. Nonetheless, a few specific risks may arise in cases where Fund resources are managed directly by the government rather than retained by the central bank:

- The transfer of Fund purchases to the government may make the associated repurchases subject to the budget appropriation process. Moreover, in debt restructuring cases this might give the impression that the Fund is competing directly with other creditors for the limited fiscal resources available to service debt.
- Governments generally have a much wider array of creditors than central banks, and to the extent that Fund credit is at lower cost than other credit, there is a financial incentive to prolong Fund borrowing through the request of extension of repayment expectations or successor arrangements.
- Governments generally do not build up large stocks of liquid assets (such as foreign exchange reserves) that are liquid and available for external payments. This means that, in cases where the government cannot rely on the central bank to make repurchases, the government may have to buy foreign exchange, or borrow these resources from the central bank or the private sector, which it may not be able to do.
- Absent a clear exit strategy for the use of Fund resources, there is a risk that fiscal policy becomes unduly reliant on Fund resources to finance what may be permanent expenditures.

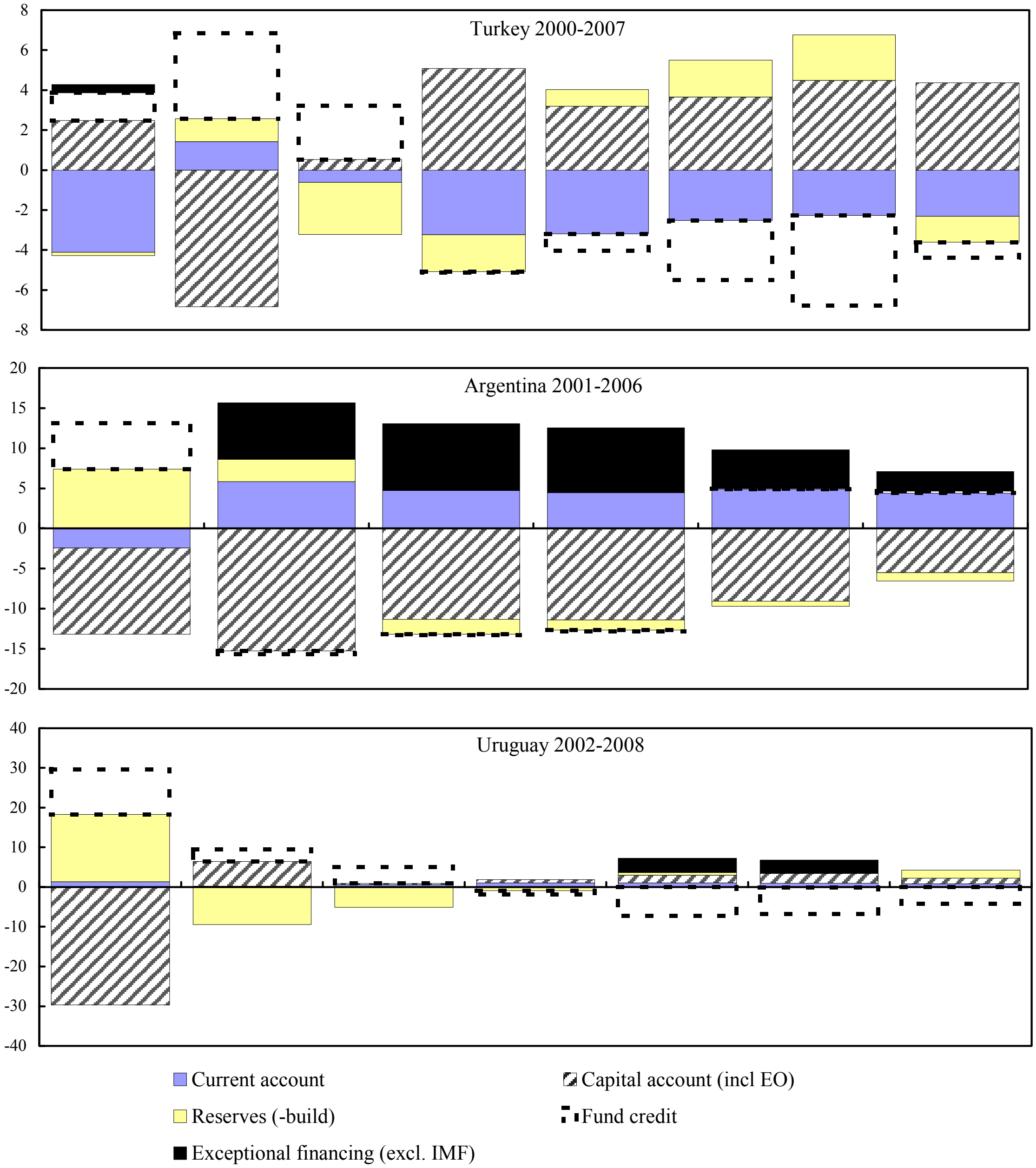
The entity that is in practice responsible for making repayments to the Fund depends on the institutional arrangements between the government and the central bank:

In **Argentina**, the central bank (BCRA) is the fiscal agent of the government and the depository for the Fund; past use of Fund resources is represented as a liability on its balance sheet. For the 2001 purchases, the corresponding asset on the BCRA's balance sheet is net credit to the government, reflecting the crediting of Fund purchases to the government's foreign exchange account. The timing of Fund repurchases is not conditional on the repayment of government credit to the central bank.

In **Turkey,** during the period from end-1999 to early 2001 Fund purchases were deposited with the central bank (CBT). Starting in May 2001, Fund credit was effectively on-lent by the CBT to the government in local currency (indexed to the SDR). The government's difficult financing situation resulted from the inability of domestic banks to provide financing at a reasonable rate because of liquidity shortage, and the effective use of Fund resources by the Treasury has allowed it to lower treasury bill rollover rates, easing debt sustainability concerns, and contributing to banking system stability. Following the amendment of the central bank law in 2001,which prohibited any direct lending by the government, Fund purchases were transferred directly into a government account at the CBT, as per instructions of the Treasury, acting as fiscal agent. The current understanding between the Treasury and the CBT is that the Treasury will provide the funds for making the associated repurchases, although the CBT will provide the funds for repurchases of some past use of Fund resources.

1/ Under the Articles of Agreement, the Fund can only provide financing when there is a balance of payments need.

Figure 6. Selected Current Exceptional Access Arrangements:
Projected BOP Financing: Sources (+) and Needs (-)
(Expressed as a percent of average annual GDP over period)



Source: IMF staff reports.

49. **The capacity to repay the Fund is premised on a continued strengthening of the net reserve position.** With no further drawings from the Fund and no further shocks, current policies should be sufficient to generate the flows necessary to ensure repayment while allowing Brazil to rebuild its reserves to pre-crisis level by 2006. Market sentiment is assumed to depend on a sharp and sustained recovery in economic growth and the maintenance of primary surpluses in excess of 4 percent of GDP to take pressure off the government's gross financing requirement and to improve debt dynamics.

50. **The authorities have indicated their intention to treat the remainder of the present arrangement as precautionary.** This should help strengthen the market confidence on which repurchases hinge. On that basis, Fund exposure will decline substantially in 2004-07 under the current repayment schedule. Outstanding Fund exposure peaked in September 2003 at SDR 23.4 billion, or 770 percent of quota. Brazil began to make net repayments to the Fund in the last quarter of 2003.

Uruguay[32]

51. **Uruguay's capacity to repay was linked originally to a recovery of assets from distressed banks, coupled with significant fiscal adjustment**. However, asset recovery has advanced only slowly, and the government assumed an increasing share of realized depositor losses during the crisis. The strategy has thus shifted to generating a greater part of foreign exchange resources through a rebound in capital inflows (return of deposits and government re-entry to capital markets), supported by strong policy implementation to increase confidence, helped by continued substantial assistance from international financial institutions. While gross reserves increased by more than expected in 2003, net international reserves are still substantially negative. Uruguay's recent access to international capital markets, following its debt restructuring with private creditors in 2003, along with the return of deposits to the banking system, suggests that some improvement is underway. However, the public sector and external financing requirements remain challenging. To repay the Fund in 2006–07 without a dramatic reduction in gross reserves, is likely to require continuing net

[32] The Fund arrangement was approved in 2002 to help Uruguay deal with its severe financial crisis, which began with an outflow of non-resident deposits as a result of the crisis in Argentina and later spread to resident deposits. Since most of these deposits were dollar-denominated, gross reserves fell correspondingly, further weakening confidence. In April 2002, the Fund approved a two-year SBA with access at SDR 594 million (194 percent of quota). As the crisis deepened, the arrangement was augmented by SDR 1.2 billion in June 2002, the strategy focused on providing resources to the BCU to allow it to extend dollar liquidity to a group of core banks, deemed to be illiquid but essentially solvent. Failure to restore confidence and the resulting worsening of the crisis led to declaration of a banking holiday in August. That same month, the Fund approved another augmentation, by SDR 376 million, bringing total access under the SBA to SDR 2.1 billion, or 694 percent of quota. At end-2003 Uruguay had Fund credit outstanding of SDR 1.6 billion (US$2.3 billion), equivalent to 530 percent of quota, 116 percent of reserves, 89 percent of exports, and 22 percent of GDP.

capital inflows, both from official and private sources. The prospects for such improvements remain uncertain, implying that successful completion of this process may require additional Fund involvement after the current arrangement. (Box 4 discusses how Fund credit is accounted for in Uruguay).

Argentina[33]

52. **The 2000/01 SBA (which predates the new framework for exceptional access in capital account crises) supported a set of economic policies designed to promote a sustained recovery of domestic demand and output, combined with a commitment to medium-term fiscal sustainability and the maintenance of the convertibility regime.** Given the currency board arrangement, Fund purchases were effectively used to ease the public sector financing constraints at a time when market financing had become prohibitively expensive. Under the second augmentation in September 2001, following further drops in market confidence and large private sector deposit outflows, purchases were used to bolster central bank reserves in an effort to strengthen confidence in the convertibility plan. The program ultimately failed, the convertibility regime collapsed, and Argentina was left with high levels of debt, including to the Fund.

53. **The staff report for the current SBA recognized that the Fund will remain highly exposed to Argentina for some time**. A key uncertainty underlying Argentina's capacity to repay the Fund is the timing of a restoration of market access. If generating the resources to repay the Fund were to depend primarily on continued current account surpluses, Argentina's capacity to repay will be limited. The capacity to repay depends more crucially on the return of investor confidence in Argentina and resumed access to international capital markets. A rapid normalization of relations with private creditors, their provision of substantial debt relief, and the government's tackling of key fiscal, banking and institutional reforms are vital.

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[33] Starting in 2001, the Fund has approved (or augmented) a number of arrangements with exceptional access for Argentina to ease public sector external financing constraints and, in 2001, to support the exchange rate. Argentina's exceptional access began in January 2001 with the augmentation of the three-year SBA that brought access to 500 percent of quota. The arrangement was augmented again to 800 percent of quota in September 2001. Access was also exceptional under the transitional SBA approved in January 2003 (103 percent of quota) and the three-year SBA approved in September 2003 (424 percent of quota). At end-2003, outstanding Fund credit equaled SDR 10.4 billion (US$14.6 billion), equivalent to 493 percent of quota, 110 percent of gross reserves, 48 percent of exports, and 12 percent of GNP.

Box 4. Uruguay—Accounting and Use of Fund Credit

In Uruguay, the liability to the Fund is on the central bank's books. The central bank deposited a portion of its corresponding gross reserves into an escrow account excluded from the central bank's reserves, and specifically earmarked to cover all unrestricted dollar deposits. This account initially contained total balances of US$1.37 billion, of which US$788 million was financed using Fund purchases, and the remainder by the World Bank and IDB.

Functioning as a "lender of last resort" facility, the escrow account was largely drawn down by banks to meet deposit withdrawals. The rationale for this arrangement was to send a clear signal that unrestricted dollar deposits would be fully repaid, as the amounts in the escrow account could be seen to cover these deposits completely. The strategy was based on the presumption that having clearly specified resources available to back deposits fully would serve to stop the run, which was ultimately the case. Lending to the escrow account by the central bank has a longer maturity than Fund financing. The escrow account has not yet been extinguished, though at end-2003 its remaining balances had dropped to US$219 million. Under Uruguay's domestic institutional arrangements, the Treasury will provide the central bank with foreign exchange equivalent to part of the Fund purchases made during the 2002 crisis.

D. Lessons from Past and Present Cases

54. **In general, all exceptional access programs in circumstances of capital account crises are designed to support the return of market confidence, thereby enabling the Fund to be repaid quickly.** However, not all programs will work as anticipated, or the envisaged adjustment may take longer or shorter than expected.[34] As a result, Fund involvement may be longer, or shorter, than initially envisaged.

55. **Notwithstanding some risks, the strategies currently in place in Brazil, Turkey and Uruguay appear to be on track, helped by a very supportive international financial environment; in Argentina conclusion of an appropriate restructuring is needed.**

- In Uruguay, strong fiscal measures and reforms being undertaken in the banking sector have helped to restore stability. As a result, market confidence has increased, the banking system has experienced a reflow of deposits, the government's borrowing spreads have declined, and market access has been substantially restored.

[34] It is noteworthy, however, that all past exceptional access cases have, in fact, adjusted well beyond what was programmed under the Fund arrangement, and accumulated foreign exchange reserves through unanticipated channels. Some observers have interpreted this experience as showing that external financing in these (exceptional access) cases was too low, leading to excessive current account adjustments.

- In Brazil, important progress is being made in the structural reform agenda, fiscal performance is in line with program targets, and vulnerabilities continue to be addressed, including the structure of public debt. As a result, demand for Brazilian assets has been strong and the central bank has started to purchase significant amounts of foreign exchange reserves in the market.

- Turkey's economic reform program is also delivering good results. Market confidence seems to be coming back and interest rates have fallen sharply. The central bank's reserve position continues to improve, while the Treasury's debt rollover seems manageable, at least in the current international environment.

- In the case of Argentina, macroeconomic conditions continue to improve. Sustaining the economic recovery will require continued prudent macroeconomic policy and implementation of structural reforms, and conclusion of a debt restructuring that leads to a sustainable public debt and allows the country to regain access to international capital markets.

56. **Despite the progress, though, important vulnerabilities remain that could cause stress in a less benign international environment or in the face of adverse shocks.** Reducing these vulnerabilities will require strict implementation of the macroeconomic policies and structural reforms under the Fund-supported programs.

57. **The remainder of this section addresses some topics that emerge from the past experience**.

58. **Applying elements of the framework for exceptional access to preexisting arrangements.** While all of the four criteria for capital account crises will not always be met, all other elements (early Board involvement, documentation requirements) apply to any request for exceptional access. However, the new framework does not formally apply to exceptional access cases approved before it came into effect, i.e., Turkey and Uruguay. Since most of the elements are designed to improve decision-making on exceptional access, they are moot once such access has been approved. However, one element of the new framework that could be extended to exceptional access cases approved before the new framework is the requirement of an *ex post* evaluation by the staff within one year after the end of the arrangement (see Box 1). The Independent Evaluation Office may also decide to assess the experience in exceptional access cases.

59. **Additional scenarios.** The difference between the *ex ante* and *ex post* repayment scenarios of past exceptional access cases highlights the role sensitivity analysis could play in providing additional perspectives. Baseline balance of payments projections tend to assume sustained policy implementation, a gradual improvement in external market conditions, and no major exogenous shocks. As is evident, actual repayment patterns may surprise both on the upside and the downside. A presentation of different scenarios could show for instance

the sensitivity to different rollover or interest rate assumptions as well as specific country-relevant shocks.

60. **Capacity to repay indicators.** In spite of the sometimes significant margin of error that has surrounded balance of payments projections, it appears that the traditional indicators of capacity to repay remain critical.[35] Reserves and exports—the main metrics against which Fund debt-service continues to be measured—remain indicative of member's capacity to generate the foreign exchange resources needed to make Fund repurchases. The use of the Fund resources in a specific sector, and the associated conditionality, may help focus attention on addressing specific underlying balance of payments vulnerabilities. In such cases, close monitoring of the sector in which the balance of payments need originated and to which Fund resources were targeted can yield important insights into the scope for overall balance of payments improvement and prospects for Fund repayment.

61. **The profile of repayments to the Fund.** Aside from issues relating to the strength of the diagnostic analysis and program design, alternative terms of Fund lending might play a role in smoothing out repayment humps and preventing repurchase problems. The current configuration of facilities, with a presumption to use SRF resources and with repurchases on the expectations schedule where possible, is aimed at capturing the "upside" in cases where the timing of the overall balance of payments improvement, either through adjustment or higher capital inflows, is very uncertain.[36] An inevitable feature of this system is that, in cases where the upside does not materialize, or indeed the balance of payments deteriorates, members may not be able to make repurchases as anticipated. The possibility of early repayment from better balance of payments developments than anticipated is also reduced or eliminated when repurchase expectations arising over a longer period of time are extended from expectations to obligations basis. (For example, in the case of Brazil, repurchases arising in 2005 and 2006 on expectations schedule were converted to obligations schedule.) Since there is a presumption that extensions would cover only repurchase expectations arising in the next twelve months, extensions of expectations arising beyond this period should only occur when the need to smooth the member's debt-service profile is compelling.[37]

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[35] In the context of the discussion of the Fund's precautionary balances, many Directors encouraged more in-depth scenario analysis of the financial impact on the Fund should members incur arrears. See BUFF/04/35, 3/2/04.

[36] The Fund's general early repurchase policy continues to serve as a backstop for those cases where members achieve an especially rapid and sustained recovery of their balance of payments, or where no other repurchase expectations have been established. See "The Fund's Early Repurchase Policy" (EBS/01/11, 2/2/01).

[37] "Summing Up by the Acting Chairman, Review of Fund Facilities—Proposed Decisions and Implementation Guidelines" (BUFF/00/175, 11/27/00).

62. **Changes to the structure of Fund charges could further help capture the upside to balance of payment projections**, but the Board has agreed, in the context of the 2000 Review of Facilities, not to consider such changes prior to the end of 2004. Higher charges—for example through more consistent use of the SRF—would provide further incentives to make early repurchases once the cost of other (market) financing declines. This might encourage members to repurchase ahead of a scheduled repayment hump. Staff is not proposing any changes at this time.

63. **Is there scope for greater use of rollover or rescheduling agreements with the private sector in providing medium-term balance of payments relief?** The role of arrangements to secure relief for the capital account is quite different for countries with acute liquidity problems than it is for those with a possibly unsustainable debt. Where balance of payments pressures are perceived to be temporary, authorities have generally encouraged private creditors to retain their exposures. Where such arrangements are formalized, this may provide an additional level of assurance about the behavior of the balance of payments under the Fund arrangement. However, where bank credit is not the dominant source of capital account financing or the source of the balance of payments pressure, the scope for replicating arrangements of the type in Korea will tend to be limited.[38] Moreover, country authorities have been wary to interfere with private sector decision making, for fear of further undermining confidence and exacerbating capital outflows. Supervisory authorities, for their part, have been similarly reluctant to apply pressure on banks as this may pose a conflict of interest with their prudential responsibilities.[39] As a corollary, in most cases, exceptional access arrangements will probably not be associated with formal measures that lock in certain capital flows.

64. **Although rescheduling arrangements have in certain instances provided valuable breathing space during the crisis itself, their contribution to enhancing countries' medium-term repayment capacity is less clear.** Efforts to prevent a large reduction in net private sector capital outflows focused on achieving immediate balance of

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[38] In Indonesia, where a similar type of restructuring arrangement was concluded, bank credit was in fact not the dominant source of financing. Much more important was bond financing, which after the crisis had to be renegotiated on a bond-by-bond basis. This process took two years to complete, an important reason why the capital account remained weak for so long.

[39] See "Involving the Private Sector in the Resolution of Financial Crises—Complementing the Catalytic Approach" (EBS/02/2, 1/8/02); "Seminar on Involving the Private Sector in the Resolution of Financial Crises—The Restructuring of International Sovereign Bonds—Further Considerations" (EBS/02/15, 1/31/03); "Involving the Private Sector in Resolving Financial Crises—Experience and Principles" (EBS/00/42, 3/7/00); "Involving the Private Sector in the Resolution of Financial Crises—Further Considerations" (EBS/99/194, 10/19/99); "Involving the Private Sector in Forestalling and Resolving Crises—Further Considerations (EBS/99/21, 3/9/99); "Involving the Private Sector in Forestalling and Resolving Financial Crises" (EBS/98/139, 8/12/98).

payments relief by rolling over claims falling due or replacing these with new ones. If the maturity of these new instruments is sufficiently long, this may provide some relief when Fund repurchases come due. In practice, however, the extension of maturities was generally too short to achieve this. In the case of the bank restructuring agreements with Korea, for instance, the maximum maturity of the exchanged bank loan was three years.

65. **In contrast, where sovereign debts have become unsustainable, or provide significant cause for concern, a formal rescheduling or restructuring of debt may be necessary** to restore balance of payments viability, and becomes a focal point of the Fund-supported program. In cases where a country's debt has clearly become unsustainable, such as in Argentina and Russia, the ability to make Fund repurchases becomes dependent on the ability to achieve successful restructuring agreements with other private and official creditors. In these circumstances, where arrears are incurred to the private sector, purchases become contingent on a completion of financing assurances reviews, in which the progress towards achieving a restructuring agreement is assessed.[40]

IV. Next Steps

66. Staff proposes that future reviews of the exceptional access policy be undertaken at the same time as the regular reviews of access policy in the credit tranches and under the EFF. The next such review is scheduled for late 2004. In the meantime, the Board will have an opportunity to discuss precautionary arrangements in June.

V. Issues for Discussion

67. This review suggests that the new framework for exceptional access in capital account crises—including the substantive criteria and the procedures and documentation requirements—has helped inform decision-making in recent exceptional access cases. It proposes that the broad principles embodied in the four criteria for exceptional access in capital account crises underlie exceptional access in all other cases as well. Directors' views would be welcome.

68. There are some situations where members may request exceptional access outside of an ongoing capital account crisis, including when members have preexisting high levels of exposure. *Do Directors agree that the principles for exceptional access set out in paragraph 13 would in each case need to be met, along with the procedural and informational requirements set out in the framework?*

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[40] The restructuring in Russia took place outside the context of a Fund arrangement, but was equally instrumental in restoring sustainability and facilitating repurchases (along side the oil-led improvement in the current account). This restructuring of Russia's debts was not anticipated at the time the augmentation of the Fund arrangement was approved in July 1998.

69. The ability of Fund arrangements to catalyze private financing can be an important element in the success of Fund-supported programs and the capacity of members to repay the Fund quickly once balance of payments improve. This hinges on improvement in the current account and a member's ability to replenish gross reserves through a turn around in the capital account based on a rebound in confidence and resumption of private capital flows. *Do current exit strategies strike the right balance in relying on adjustment versus renewed private financing—in generating the resources necessary to repay the Fund?*

70. The current configuration of facilities with a presumption to use SRF resources and repurchases on the expectations schedule where possible, is aimed at meeting the exceptional demand for Fund resources in capital account crises, while setting incentives for repayment to the Fund once a members' balance of payments improves. *Do Directors view the current configuration of facilities as appropriate?*

71. Contrary to exceptional access arrangements for Mexico and the Asian countries, official financing from other sources than the Fund (both bilateral and multilateral) has played a smaller role in meeting countries' gross financing requirements. *What are Directors' views on the desirability of obtaining financing commitments from other official sources in exceptional access cases?*

72. The paper has described several instances where Fund purchases were used as a source of budget financing, in an attempt to address underlying balance of payments need. *Do Directors view such use of Fund resources as posing particular risks?*