CONFIDENTIAL

Copy to Mr. Dallara
Mr. Erb
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# Office Memorandum

1985 DEC 24 AM 9:49

TO : Mr. J. De Larosiere
Managing Director

DATE: Dec. 23, 1985

FROM : Salvatore Zecchini

SUBJECT : Italian bankers' endorsement of the "Baker proposal".

Following our previous conversations on the above subject, I wish to transmit to you copy of the message sent by the Associazione Bancaria Italiana to the President of FRB of New York for the purpose of endorsing Secretary Baker's proposal.

In the enclosed statement specific reference is also made to the recent joint statement made by you and Mr. Clausen.

RCV: @1IM/4.03949 Line: 4

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1985 DEC 23 PM 1:40

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ATT. DR. SALVATORE ZECCHINI
===========================

TRASMETTO QUI DI SEGUITO, PER OPPORTUNA CONOSCENZA, IL TESTO DEL TELEX CHE IL PROF. PARRAVICINI, PRESIDENTE DELL'ASSOCIAZIONE BANCARIA ITALIANA, HA INVIATO A MR. CORRIGAN, PRESIDENTE DELLA FEDERAL RESERVE BANK DI NEW YORK NEL QUALE E' ESPRESSA LA POSIZIONE DELLE MAGGIORI BANCHE ITALIANE RELATIVAMENTE AL PIANO BAKER.

DEAR MR. CORRIGAN,

WE RECALL WITH PLEASURE THE MEETING HELD ON NOVEMBER 9TH LAST IN THE OFFICES OF OUR ASSOCIATION, AT WHICH YOU ADDRESSED A GROUP OF LEADING ITALIAN BANKS ON THE U.S. ECONOMY AND ON THE INITIATIVE ANNOUNCED BY THE HON. JAMES A. BAKER III, SECRETARY OF THE U.S. TREASURY, AT THE ANNUAL MEETINGS OF THE I.M.F. AND THE I.B.R.D. HELD IN SEOUL AT THE BEGINNING OF OCTOBER THIS YEAR.

FOR ITS PART , THE ITALIAN BANKING COMMUNITY HAS EXTENSIVELY DISCUSSED THE LATTER SUBJECT (ALSO ON THE BASIS OF THE RECENT JOINT STATEMENT MADE BY MR. CLAUSEN AND MR. DE LAROSIERE) AND HAS BASICALLY AGREED THAT THE HON. BAKER'S PROPOSALS REPRESENT A CONSTRUCTIVE AND REALISTIC APPROACH TO THE INTERNATIONAL DEBT PROBLEM. ACCORDINGLY, THE MAJOR ITALIAN BANKS STRESS THE IMPORTANCE OF APPROACHING THIS ISSUE ON A CONTINUING CASE BY CASE BASIS. IN THIS CONTEXT THEY SEEM TO BE INCLINED TO TAKE A FAIR SHARE SUBJECT TO THE AVAILABILITY IN ITALY OF APPROPRIATE FISCAL PROVISIONS AND TO THE GRANTING BY THE ITALIAN AUTHORITIES OF THE RELEVANT AUTHORIZATIONS FOR FUNDING AND LENDING OPERATIONS.

IT IS ASSUMED OF COURSE THAT ALL THE OTHER PARTIES CONCERNED - BOTH GOVERNMENTS OF CREDITOR COUNTIES, AND IN PARTICULAR THEIR INSURANCE AGENCIES, AND GOVERNMENTS OF DEBTOR COUNTRIES, MULTILATERAL INSTITUTIONS AS WELL AS THE OTHER CREDITOR COUNTRIES' COMMERCIAL BANKS - BEAR THEIR PROPORTIONATE SHARE OF THE TASK OF ACHIEVING THE ULTIMATE AIM NOT ONLY OF SOLVING THE INTERNATIONAL DEBT PROBLEM, BUT ALSO OF BRINGING ABOUT THE RETURN (IT IS TO BE HOPED, IN THE NOT-TOO-DISTANT FUTURE) TO COMPLETE NORMALITY IN BOTH TRADE AND FINANCIAL RELATIONS BETWEEN THE INDUSTRIAL AND THE DEVELOPING WORLD.

INCOMING CABLE/TELEX

R YOUR FULL KNOWLEDGE, WOULD YOU PLEASE NOTE THAT COPIES
THE PRESENT TELEX WILL BE ALSO SENT TO MR. DE LAROSIERE
ND MR. CLAUSEN THROUGH THE ITALIAN EXECUTIVE DIRECTORS.

BEST PERSONAL REGARDS''

LE SARO' PERTANTO MOLTO GRATO SE VORRA' CONSEGNARE COPIA DEL
TELEX A M. DE LAROSIERE.

CON I PIU' CORDIALI SALUTI ED I MIGLIORI AUGURI

FELICE GIANANI
DIRETTORE GENERALE
ASSOCIAZIONE BANCARIA ITALIANA

TELEX N. 1229

WELL RECEIVED?

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Time: 12:47 12/23/85 ???
Connect Time : 656 seconds

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DEC 23 1985
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INCOMING CABLE/TELEX

MD o/r

OMD-85/7052
Translated by Y. Firestone
692668

DEC 19 1985 0848

MR. PEDRO PEREZ FERNANDEZ
EXECUTIVE DIRECTOR
INTERNATIONAL MONETARY FUND
WASHINGTON

MADRID, DECEMBER 19, 1985 2:47 P.M. MMV/23311

Following your telex of December 13 on the Baker initiative, the Governor contacted President of the Spanish Association of Private Banks (AEB), advising him of the concerns voiced in your telex. The AEB President has sent the Governor a reply the text of which is reproduced below:

"Dear Governor:

"I refer to my conversations with you following the publication of communiqués by certain U.S., U.K. and Japanese banks supporting the Baker initiative in general terms without committing themselves substantively.

"The matter was discussed by the AEB's General Council yesterday, and I can confirm to you that, while Spain's banks welcome Mr. Baker's initiative, they do not appear prepared even to make declarations along these lines so long as they cannot have access to detailed information on the key elements of the plan and, generally speaking, so long as there is no change in the conditions under which the banks have heretofore had to proceed with regard to debtors experiencing difficulties.

"The fact of the matter is that Spain's banks feel that, although the amount of their credits to Latin American countries is fortunately not excessively high in relative terms, in view of their special and traditional role in the area they should have been accorded greater consideration in the earlier stages of the negotiations, rather than come under pressure, at the last minute, to give a hurried endorsement to plans or programs in the formulation of which they had taken no part.

"Not only have Spain's banks obtained no information from the Steering Committees--something of which other European banks have also complained, according to reports reaching us--but, as you know, when the AEB recently tried to find out what had been discussed by the Group of 18 at its Toronto meeting and suggested sending an observer to the following meeting of that group of banks, which took place last week in London, all we got was polite evasiveness.

"I regret being unable to give you any better news at this time, but we are continuing to consider this most important subject among ourselves and in close contact with you.

"Best regards."

CORDIALLY

JOSE LUIS FEITO
CHIEF OF RELATIONS WITH INTERNATIONAL ECONOMIC ORGANIZATIONS
BANK OF SPAIN

Received in Cable Room
December 19, 1985

Mr. Kincaid
Mr. Wiesner

INTERNATIONAL MONETARY FUND
WASHINGTON, D. C. 20431

INTERNATIONAL MONETARY FUND
WESTERN HEMISPHERE DEPT.
1985 DEC 26 PM 3:52

EW
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P

DEPUTY MANAGING DIRECTOR

CABLE ADDRESS
INTERFUND

December 26, 1985

MEMORANDUM

To: Mr. Gondwe
Mr. Tun Thin
Mr. Whittome
Mr. Wiesner

From: Richard D. Erb

Subject: MD's Meeting with Bankers on January 6

As you are aware, the Managing Director and the President of the World Bank will be meeting with a number of commercial bankers on January 6 to discuss the status of the Baker initiative. It would be useful to have a brief up-to-date status report on each of the countries in your region included in the group of 15 countries mentioned in the Baker initiative. In addition, you could also include brief status reports on countries which might also be candidates under the same framework. Inter alia, the status report should include brief sections on external financing requirements for 1986 (and where possible 1987 and 1988) as currently envisaged; the status of commercial bank relations, and the status of World Bank plans.

Please send these reports by close of business December 31 to Max Watson who is preparing briefing books for the Managing Director and myself.

cc: Mr. Watson
Mr. Kincaid

# Office Memorandum

EXCHANGE & TRADE RELATIONS

To: Mr. Finch

December 30, 1985

From: L.A. Whittome

Subject: Drafts for MD's Meeting with Bankers on January 6

I have no major point to raise on your draft remarks. I thought that the approach used is very much what is wanted.

Three points only:

(1) from all I hear the banks will take the opportunity to press the Bank and the Fund hard. I think we should give the Managing Director a separate short paper setting out some of the points on which we need to press the banks, e.g., in what form can prior commitments on financing be given? Can a country adhering to an agreed program be assured of the continuity of financing?

(2) the first category of countries appears on page 3; the second is somewhat lost on page 7, and the third on page 8. The distinction between the three categories of countries could come out more clearly; and

(3) the grammar is loose in some sections and I have written in some suggested changes. This will matter if the text should be distributed in written form.

Attachment

cc: Mr. Hood
Mr. Ouattara
Mr. Tun Thin
Mr. Wiesner
Mr. Watson
Mr. Kincaid

EBD/85/325

December 24, 1985

To: Members of the Executive Board

From: The Secretary

Subject: Debt Strategy - Statement by U.K. Commercial Banks

The following message dated December 12, 1985 from U.K. commercial banks has been received in the Fund:

Baker Initiative

The banks listed below and the members of the Accepting Houses Committee are aware of the proposals relating to the handling of the present phase of world debt problems put forward by Mr. Baker at the Annual Meetings of the IMF and IBRD in Seoul at the beginning of October 1985. They are also aware of the support for the proposals given by the Governors of the Central Banks of the Group of 10, as reported in the press after their meeting in Basle on November 11-12 and of the support of the British Government.

They have now noted your joint statement of support, dated December 2, on behalf of the World Bank and of the IMF. In addition to the elements of Mr. Baker's proposals which you list, the banks lay great importance on his argument, in relation to debtor countries, that "capital flight must be reversed."

Mr. Baker's initiative is welcomed as a positive and constructive approach and the banks confirm their willingness to play their part on a case-by-case basis, provided that all other parties, governmental, institutional and banking, do the same.

Sir Donald Barron, Chairman, Midland Bank
Sir Jeremy Morse, Chairman, Lloyds Bank
Lord Boardman, Chairman, National Westminster Bank
Sir Timothy Bevan, Chairman, Barclays Bank
Sir Michael Herries, Chairman, Royal Bank of Scotland
Lord Barber, Chairman, Standard Chartered Bank
Sir Thomas Risk, Governor, Bank of Scotland
Mr. Robin Hutton, Director General, Accepting Houses Committee

Other Distribution:
Department Heads

DOCUMENT OF INTERNATIONAL MONETARY FUND AND NOT FOR PUBLIC USE

61

FINCH, C. DAVID
ROOM 5-100 01

EBD/85/324

December 24, 1985

To: Members of the Executive Board

From: The Secretary

Subject: Debt Strategy - Statement by Japanese Commercial Banks

The following communication dated December 12, 1985 from the Bank of Tokyo for and on behalf of the below-mentioned institutions has been received in the Fund:

> The following Japanese banks gathered in Tokyo this week and discussed intensively the proposals made by the Hon. James A. Baker, III, Secretary of the Treasury and Governor of the Bank and the Fund for the United States at the Annual Meetings of the IMF and IBRD in Seoul.
>
> We are very well aware of Mr. Baker's proposals and we are also aware of the support for the proposals given by the Governors of the central banks of the Group of Ten. We also welcome Mr. Baker's initiative as a positive and constructive approach and confirm our willingness to consider a contribution on a case-by-case basis, provided that all other parties: debtor governments, creditor governments, international institutions, and other financial institutions do the same.
>
> Very sincerely yours,
>
> The Bank of Tokyo, Ltd.
> The Bank of Yokohama, Ltd.
> The Dai-Ichi Kangyo Bank, Limited
> The Daiwa Bank, Limited
> The Fuji Bank, Limited
> The Hokuriku Bank, Ltd.
> The Industrial Bank of Japan, Limited
> The Long-Term Credit Bank of Japan, Limited
> The Mitsubishi Bank, Limited
> The Mitsubishi Trust and Banking Corporation
> The Mitsui Bank, Limited
> The Sanwa Bank, Limited
> The Sumitomo Bank, Limited
> The Tokai Bank, Limited

Other Distribution:
Department Heads

FINCH, C. DAVID
ROOM 5-100 01

EBD/85/322

December 23, 1985

To: Members of the Executive Board

From: The Secretary

Subject: Debt Strategy - Statement by French Commercial Banks

The following statement issued on December 13, 1985 by the Association Française des Banques on behalf of the French banks has been received in the Fund:

The "Baker Initiative"
Statement of the French Banks

French banks are aware of the proposals relating to the handling of the present phase of world debt problems put forward by Mr. Baker, Secretary of the U.S. Treasury, at the Annual Meetings of the IMF and IBRD in Seoul. They are also informed of the support for these proposals given by the Governors of the Central Banks of the Group of Ten at their last meeting in Basle on November 11 and 12.

The French banking community, which in the last few years made an especially important effort in favor of the most indebted countries, considers that a satisfactory implementation of these proposals depends on the will of all countries concerned, both debtors and creditors, to promote the necessary conditions in the management of their own economy as well as world economy, in particular with regard to growth, trade and payment balances and interest rates.

At this stage, French banks view Mr. Baker's initiative as a constructive approach. They consider joining it, on a case-by-case basis, without a country priority list and provided that all other parties concerned, governments and intergovernmental institutions simultaneously play their part in an increase of net contributions.

Given the nature and magnitude of the problem, French banks do emphasize the indispensable part to be played by governments as well as by the IMF, the World Bank and all other institutions dealing with development assistance. In this respect, French banks wish that the breakdown of efforts envisaged in Mr. Baker's plan be amended.

Other Distribution:
Department Heads

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FINCH, C. DAVID
ROOM 5-100 01

EBD/85/323

December 24, 1985

To: Members of the Executive Board

From: The Secretary

Subject: Debt Strategy - Statement by Canadian Commercial Banks

The following statement issued on December 13, 1985 by the Canadian Bankers Association on behalf of the Canadian banks has been received in the Fund:

Statement of Canadian Banks with Respect to the Baker Program for Sustained Economic Growth

The proposals to alleviate the developing country debt crisis introduced by Treasury Secretary James A. Baker at the Meetings of the IMF and IBRD in Seoul last October have stimulated positive debate and established a sharper focus on this very difficult problem.

The emphasis that Secretary Baker has placed on economic growth as a key element in any longer-term solution to the debt problem is particularly welcome. The recognition by creditor governments that there is a critical role for them to play in the process is integral to the successful solution of the debt problem.

These proposals call for a significant commitment by all parties involved in the process--governments of both debtor and creditor countries, the multilateral lending agencies as well as the banking community. We intend to play our part on a case-by-case basis recognizing that various institutional and other mechanisms may be necessary for orchestrating the support required from all major participants.

Other Distribution:
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FINCH, C. DAVID

ROOM 5-100 01

EBD/85/321

December 23, 1985

To: Members of the Executive Board

From: The Secretary

Subject: Debt Strategy - Statement by U.S. Commercial Banks

The following press release issued on December 11, 1985 by the U.S. Consultative Group has been received in the Fund:

> United States banks today declared their support for the international debt program proposed by U.S. Treasury Secretary James A. Baker, III to foster sustained growth in the developing countries.
>
> "Banks representing more than 95 percent of loans to the 15 countries have responded to date and have indicated that they welcome Secretary Baker's initiative as a positive and constructive development," stated letters to the Secretary of the Treasury, the International Monetary Fund and the World Bank from the U.S. Consultative Group, which was formed to coordinate the response of U.S. banks to the Baker proposal.
>
> The letters, signed by Lewis T. Preston, chairman of Morgan Guaranty Trust Company, in his capacity as chairman of the group, said: "We are in contact with U.S. banks that have loans to one or more of the countries noted in the proposal, and they confirm their willingness to play their part on a case-by-case basis, provided that all other parties, governmental, institutional, and banking, do the same."
>
> The letters also said: "We believe that the response reflects the willingness of the U.S. banking community to work closely with you and others who will be involved in this important cooperative effort."
>
> The U.S. Consultative Group said it is continuing to discuss the program with other banks and expects further indications of support.

Other Distribution:
Department Heads

Ms. Finch

Office Memorandum

To: Mr. Crockett

December 18, 1985

From: C.M. Watson

Subject: Monitoring the Baker Initiative

Thank you for sending me the draft memorandum dated December 13. The coverage of data in the draft and attached tables is comprehensive, and the brief interpretative text that will accompany the quarterly submissions will be very useful in highlighting key developments. There are two areas where we have comments or questions.

First, this exercise will be sent to area departments when creditor data for a quarter become available. Therefore, thought will need to be given to how this will mesh with the existing quarterly forms on banking data that have been sent to area departments by the Bureau of Statistics and Exchange and Trade Relations Department to check estimates of banking flows to and from individual developing countries. The existing quarterly exercise is already rather massive, and the country coverage overlaps with that of the Baker monitoring exercise. The Baker monitoring is based on the creditor component of the IBS, whereas the existing exercise is based on creditor and debtor components, albeit with a watchful eye on the problem of inconsistent reporting. (This problem was a prime reason for the quarterly exercise.)

We worry considerably about approaching area departments simultaneously with two exercises that overlap in their country coverage and are based on differing components of the IBS data. The existing quarterly exercise is used in preparing the quarterly SM on international banking activity that is sent to the Board. Presumably, this Board paper will also need to reflect developments in the Baker group to some degree, and there may be a case for unifying the two exercises seeking data from area departments.

Second, there are a number of technical questions about the data in the draft memorandum and tables:

1. The country specific data in the draft tables relate to the Baker group only, with a comparator aggregate of a number of other developing countries. In light of concern outside the United States about the appropriateness of the list of 15 countries, and the possible impact on other countries, it might be useful to extend the coverage of specific countries.

2. Is it really right to introduce yet a further set of banking data in reports to management--the IBS creditor data?

3. The determining reason given for using the IBS instead of the BIS is that the "BIS data on lending are not as yet available on a

INTERNATIONAL MONETARY FUND

61

FINCH, C. DAVID
ROOM 5-100 11

PRESS RELEASE NO. 85/41

FOR IMMEDIATE RELEASE
December 15, 1985

Statement by the Managing Director of the International Monetary Fund and the President of the World Bank on the Debt Strategy

In a statement issued on December 2, the President of the World Bank and the Managing Director of the IMF expressed their strong support for the debt initiative proposed by the Governor of the Fund and the Bank for the United States, Secretary of the Treasury James A. Baker, III, on the occasion of the Annual Meetings of the IMF and the World Bank in Seoul, Korea in October 1985. Secretary Baker's initiative which he described as "a program for sustained growth" is designed to strengthen the international debt strategy and to deal with the debt problem in the context of growth and adjustment.

Over the last few days, the international banking community has also been expressing its support for the debt initiative in messages received by the Managing Director of the IMF and the President of the World Bank. Up to now representatives of banks from the major financial centers, accounting for an overwhelming majority of bank claims on heavily-indebted, middle-income countries have welcomed Secretary Baker's initiative as a positive and constructive approach and confirmed their willingness to play their part on a case-by-case basis, in collaboration with all other parties, in the implementation of the debt strategy.

The President of the World Bank and the Managing Director of the IMF welcome these positive and encouraging expressions of support for the debt initiative from the banking community and look forward to cooperating with the banks in putting the strategy into practice quickly and effectively.

External Relations Department • Washington, D.C. 20431 • Telephone 202-623-7100

b



# *Office Memorandum*

To: The Managing Director
The Deputy Managing Director

December 13, 1985

Dec 14, 85

From: C. David Finch

Subject: Letter to Mr. Abalkhail

I attach a letter to Mr. Abalkhail containing the responses you approved.

yes You may wish to send a copy of this letter to Mr. Nimatallah.

cc: Mr. Shaalan
Mr. Brown

# INTERNATIONAL MONETARY FUND

2701

## REQUEST FOR TRANSMITTAL OF HIGH PRIORITY DOCUMENT(S)

| REQUESTED BY | | ROOM NO. | DATE |
|---|---|---|---|
| C.M. Watson | | 5-548 | 12/13/85 |

| DEPT. | DIVISION | SECTION |
|---|---|---|
| ETR | Int'l Capital Markets | |

**TRANSMIT DOCUMENTS TO:**

NAME OF ADDRESSEE: His Excellency Sheikh Mohammed Abalkhail

FULL ADDRESS: Ministry of Finance and National Economy
Street Address
(Do not use P.O. Box No.)
City, State, Zip Code: Riyadh, Saudi Arabia
Country: Saudi Arabia

PHONE or TELEX NO.: 201669FINANS SJ

**SPECIAL INSTRUCTIONS:**

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**CONTENTS OF PARCEL (Please check)**

☐ DOCUMENT(S) ☐ PUBLICATION(S) ☐ COMPUTER TAPE(S)

[XX] OTHER(Please Specify) Letter

LENGTH OF DOCUMENT (No. of pages & copies)

PROOF OF DELIVERY (If available) [XX] YES ☐ NO

ACCEPTABLE DELIVERY TIME ☐ 24 HOURS [XX] 2 to 3 DAYS ☐ 3 to 5 DAYS

Maxwell Watson
Signature of person authorizing transmittal

12/13/85
Date

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10-29-84

INTERNATIONAL MONETARY FUND
WASHINGTON, D. C. 20431

MANAGING DIRECTOR

CABLE ADDRESS
INTERFUND

December 16, 1985

Dear Mr. Minister:

I very much enjoyed seeing you in Seoul, and recall the most interesting discussions we had, including on the debt situation. Mr. Shaalan reported to me on his meeting with you regarding the U.S. Treasury debt initiative. In particular, he referred to a number of issues you raised, notably the list of countries covered by the U.S. initiative, the nature of the conditionality involved, the issue of trade restrictions, and the basis for determining shares of lending.

With regard to the initial list of developing countries put forward by the U.S. Treasury, this list includes Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Ivory Coast, Mexico, Morocco, Nigeria, Peru, Philippines, Uruguay, Venezuela, and Yugoslavia. This list of countries is not, however, considered exclusive. Some of these countries may not need net new bank lending, while other countries may be added to the list. In addition to the provision of net new loans to this group of countries, the U.S. initiative indicated that it would be necessary for banks to continue to provide net new loans to developing countries now receiving adequate spontaneous bank financing, provided that these countries maintain sound policies, and to consider lending to other developing countries experiencing debt-servicing problems that require relatively small amounts of commercial bank loans under agreed adjustment programs.

You also asked about the nature of the conditionality involved in the U.S. proposals. Secretary Baker has emphasized that comprehensive policy action is essential for countries to strengthen their debt-servicing capacity and provide the foundation for sustained growth. In this regard, both macroeconomic and structural policies will be crucial. Prudent demand management policies will remain indispensible for establishing the conditions for long-term growth, and the proposals also place considerable emphasis on supply side policies. The Fund's involvement would continue to be based on stand-by or extended arrangements which would incorporate a combination of demand and supply-side measures tailored on a case-by-case basis to the situation of individual countries. In addition, cooperation with the World Bank and other multilateral development banks will permit the design and monitoring of enhanced structural policies in areas such as tax reform, market-oriented pricing, reduction of labor market rigidities, and opening of economies to foreign trade and investment.

In your conversation with Mr. Shaalan the issue of trade restrictions was raised. The importance of removing such restrictions was stressed by Secretary Baker in his Seoul speech. He stated that a key element in structural reforms should be "market-opening measures to encourage foreign direct investment and capital inflows, as well as to liberalize trade, including the reduction of export subsidies." The availability of additional external resources would increase the scope for countries to move swiftly in dismantling restrictions. Fund programs will emphasize the need to remove trade and payments restrictions, while an important aspect of the World Bank's involvement also will lie in the removal of distortions affecting foreign trade.

Finally, you asked about the basis for determining shares in lending to debtor countries. Countries on the Baker list have all experienced payments difficulties, including the inability to raise spontaneous bank financing. So long as adequate spontaneous flows are unavailable, bank lending is expected to remain on a concerted basis. Under these circumstances, equitable burden-sharing will continue to be of great concern to lenders. As work by commercial banks on the U.S. initiative proceeds, an important issue will be to review the procedures for assembling new money packages, with a view to determining the best modalities which command widespread support. In this connection, experience indicates that banks' existing exposure is likely to continue to provide a basis for determining burden-sharing that can be generally accepted by the banking community.

In closing I would add that I believe the U.S. initiative to be very helpful and timely in focusing the attention of the international community on the need to secure continuing progress in resolving the debt problem. In this regard, I have been very heartened by the support that has been expressed for the initiative. The task now will be to translate this into concrete actions as soon as possible.

I look forward to seeing you in the not too distant future.

Sincerely yours,

Larosière

J. de Larosière
Managing Director

His Excellency
Sheikh Mohammed Abalkhail
The Minister of Finance and National Economy
Ministry of Finance and National Economy
Riyadh, Saudi Arabia

[redacted] [redacted]



cc: Mr. Shaalan
Mr. Watson

yes
Please have these moving forward to Mr. Nimatallah (letter from me)
Dec 12.85

# Office Memorandum

To: The Managing Director
The Deputy Managing Director

December 12, 1985

From: C. David Finch

Subject: Response to Questions from Saudi Arabia on the Baker Initiative

Mr. Shaalan, in his cable from Riyadh on December 7, indicated that certain questions had been raised concerning the Baker initiative. Attached please find draft responses that could be communicated to Mr. Nimatallah. These responses have benefitted from comments by Mr. Shaalan.

Attachment

cc: Mr. Shaalan
Mr. Brown

done 12/9/85

Copy to Mr Erb

MW

RECEIVED
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1985 DEC -8 AM 9:23

Mr. Finch

cc Mr. Boorman

Mr. Kincaid

Mr. Shalaan suggests some answers to the Minister's questions should be transmitted to Nimatallah

INCOMING CABLE/TELEX

RCV: @1IM/2.12717 LINE: 2 691175

DEC 08 1985 0838
440040 FUND UI

201255 IHCHOT SJ

201255 IHCHOT SJ

TELEX TO : 440040 UR INTERFUND
8TH DEC 1985

THE MANAGING DIRECTOR

FURTHER TO MY FACSIMILE MESSAGE OF DEC.07. WISH TO ADVISE YOU THAT GOVERNOR AL SAYARI IS OUT OF SAUDI ARABIA.

BEST REGARDS

SHAALAN

440040 FUND UI

201255 IHCHOT SJ

REPLY VIA ITT

?
TIME: 08:36 12/08/85 ???
CONNECT TIME : 71 SECONDS

RECEIVED
DEC 9 - 1985
EXCHANGE & TRADE RELATIONS

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691173

1985 DEC -7 PM 12: 20

CONFIDENTIAL

TO BE DELIVERED TO THE MANAGING DIRECTOR AS SOON AS POSSIBLE

As per your instructions I met with the Minister privately to discuss the subject you brought to my attention over the phone. The Minister listened carefully and raised the following four points.

1. The Minister enquired about the coun-ries that would benefit from the scheme. I informed the Minister that the list of 15 countries mentioned by the Secretary was purely illustrative and as far as I knew no final decision was made on the countries that would be eligible to benefit from this scheme. The Minister expressed the desire to have a list of these countries. This appeared to be an important issue to him.

2. The Minister wished to know the policy guidelines, including conditionality, by the Fund and Bank that would govern the use of these credits by participating countries. Specifically he wondered whether countries using these credits would require a program with the Fund similar to the present stand-by arrangement. The Minister was aware that participation in the scheme was conditional on the pursuit of appropriate adjustment policies by the concerned countries. However, he wished more specifics on the nature of the conditionality and whether it would in any way go beyond the conditionality now used in stand-by programs.

3. The reason the Minister brought up the last point in 2. above is his concern about the removal of trade restrictions and the reduction of protectionism. The Minister enquired whether the conditionality attached to this scheme would include removal of impediments to free trade beyond what the Fund and Bank normally ask in their programs.

4. The Minister enquired into the modalities of the distribution of the U.S. dollar 20 billion between participating banks. In this connection he wished to know the criteria for determining the share of each participating bank in extending credit.

I advised the Minister of the progress so far reflected in the manifestation of support you have received from some banks and the status of progress with other banks as you have advised me over the phone. I emphasized the importance you and Mr. Clausen placed on speedy implementation of this scheme in order to improve market sentiment particularly in view of the forthcoming meetings of Latin American debtor countries in mid-December.

In a mild way I also brought up the issue of how commercial banks in Saudi Arabia could join this initial expression of support. As expected the Minister did not comment.

I propose for your consideration that to the extent we have answers to the above queries by the Minister these should be communicated as soon as possible to Mr. Nimatallah so he can communicate them to the Minister.

Best regards

Shaalan

MR. Finch

# Office Memorandum

To: The Managing Director
The Deputy Managing Director

December 13, 1985

From: C. M. Watson

Subject: U.S. Debt Initiative: Reactions of Japanese Banks

During the course of the Article IV mission to Japan, opportunities arose to discuss Japanese banks' attitudes to the Baker initiative with the Bank of Tokyo and the Japan Centre for International Finance. The following main points emerged.

First, no doubts were expressed concerning the general willingness of the Japanese banks to play their part in arrangements to implement the Baker initiative. The principal concern raised was that fair burden-sharing among countries and banks should be strictly observed. It was suggested that Japanese banks had shown more cohesion and discipline than other national groups of banks in implementing concerted lending and maintenance of exposure arrangements. In this connection it was emphasized that the 1982 base dates for exposure should be maintained, to avoid penalizing banks that had participated fully in concerted arrangements. It was feared that the next three years could see further weakening of some other banks' support, especially in the case of U.S. regional banks, so that more effective monitoring would be needed to ensure that Japanese banks did not bear an inequitably large part of the burden. The difficulty of securing the participation of "small banks" was seen as mainly a U.S. problem, but there was concern also about participation by banks in countries such as Spain and Singapore. The possibility of country specific trust funds for banks with small exposures was mentioned as worth studying; by contrast, Japanese banks saw no attraction in interest capitalization.

At the time of these contacts, work was proceeding to secure the statement of general support for the Baker initiative that has just been received. The Bank of Tokyo, together with Dai-Ichi Kangyo Bank, had held two meetings to rally support. Other banks had taken the opportunity of these meetings to raise a variety of questions. In addition to international burden-sharing, these issues included the rationale for the list of 15 debtor countries; the basis of "allocating" the $20 billion among debtor countries; and a general concern about the implications of advance commitment to a plan for which so few details were available. On this latter point, the Bank of Tokyo indicated that Japanese banks should give general support to the process described in the Baker initiative, and then play an active role in helping to shape the details on a case by case basis. There was also a desire among the banks to extract from the Japanese authorities some concessions in return for their support for the proposals. The concessions sought included official loan guarantees (from the government or the World Bank), tax concessions on loan provisioning, and a commitment to stimulate the economy to improve the outlook for developing country exports. The authorities have been strongly discouraging demands for guarantees and tax concessions.

In conversations with banks and the authorities we again raised the issue of mandatory loan provisioning on new exposure to countries that have rescheduled in the past five years. There was broad agreement that this regulation would not prevent concerted lending under the U.S. Treasury initiative; in that context the main issue was to obtain an increase in the very modest degree of tax relief currently available (1 percent of amounts newly rescheduled or advanced). But the provisioning requirements were seen by banks as inhibiting a return to spontaneous lending for countries that have rescheduled, until the end of the five year period, because banks would not find it prudent (or profitable) to lend to countries still included in the official basket of "problem debtors." In present circumstances this appears a somewhat less immediate concern, but the authorities are aware that we intend to continue to press this issue. There are now some indications that flexibility could be contemplated in the face of clear evidence (perhaps based on a specific case) that the requirements would constitute an obstacle to a resumption of market lending to a country whose improved creditworthiness would otherwise justify this.

cc: Mr. Finch
Mr. Tun Thin
Mr. Narvekar
Mr. Smith
Mr. Brown

Mr. Finch

# Office Memorandum

To: The Managing Director
The Deputy Managing Director

December 12, 1985

From: C. M. Watson

Subject: Responses to the Baker Initiative

As you requested, we have prepared estimates of the percentage of bank exposure to the 15 Baker Initiative countries that is accounted for by creditor banks from which positive indications have been received. Assuming that positive indications will be received from all Canadian and French banks also, it is estimated that banks holding 76-77 percent of exposure to the 15 countries will have signalled their general support. The exposure of all banks in the countries from which such indications have been received amounts to approximately 90 percent of total exposure to the 15 countries. The data underlying these estimates are shown in the attached table. They are based on a number of assumptions:

1. As regards bank participation, the table shows for each of the specified creditor countries both the total exposure of banks in the country and the exposure of those banks that have already given positive indications. (The UK participation rate is relatively low in part on account of the absence of consortium banks based in London that are specialized in Latin American lending.) At the foot of the table, we have then added in the remaining French banks and all the Canadian banks. On the basis that these additional banks indicate support, overall ratios for "committed banks" and "all banks" in these creditor countries are shown.

2. For six debtor countries (Argentina, Brazil, Chile, Mexico, Philipines, and Yugoslavia) we have creditor breakdowns by country and by bank derived from advisory committee data. While base dates are not uniform, data are for 1982-83 and can be aggregated with some degree of confidence.

3. For Venezuela, we have a breakdown by creditor country only and have therefore applied bank participation ratios derived from the average of the other four WHD cases.

4. Together, the seven debtor countries cited above account for some 86 percent of the bank debt of the Baker group. For the remaining debtor countries we have examined exposure shares derived from published sources for those creditor countries that do provide such data - United States, United Kingdom and Germany (such data are for December 1984, since they are not fully available for the earlier period.) Broadly, the U.S. share is relatively high in the smaller WHD countries. Moreover, it can be assumed that the French share is high in

the Ivory Coast and Morocco. Since the United States and France are considered "high participation" creditor countries, this could raise the total participation ratio slightly. In addition, the U.K. participation in Nigeria is estimated to be significantly higher than in Latin America, because the UK-based Latin consortia, which are presently not committed, are presumably not involved in Nigerian business. Thus, it is estimated that inclusion of these additional eight smaller debtor countries would, at worst, not significantly depress the aggregate bank participation percentage.

cc: Mr. Finch
Mr. Brown

Table . Commitments to the Baker Initiative
(In billion of U.S. dollars)

| | Argentina | Brazil | Chile | Mexico | Philippines | Yugoslavia | Venezuela (estimated) | Total |
|---|---|---|---|---|---|---|---|---|
| Belgium | | | | | | | | |
| All banks | 0.63 | 0.58 | 0.14 | 1.04 | 0.04 | 0.02 | na | 2.45 |
| Committed banks | 0.04 | 0.11 | 0.01 | 0.13 | -- | -- | na | 0.30 |
| France | | | | | | | | |
| All banks | 1.89 | 4.75 | 0.34 | 4.77 | 1.00 | 0.62 | 1.55 | 14.92 |
| Committed banks | 0.61 | 1.02 | 0.04 | 1.08 | 0.31 | 0.07 | 0.36 | 3.49 |
| Germany, Fed. Rep. of | | | | | | | | |
| All banks | 2.85 | 4.10 | 0.72 | 2.86 | 0.83 | 0.88 | 0.99 | 12.78 |
| Committed banks | 1.15 | 2.16 | 0.50 | 1.37 | 0.27 | 0.31 | 0.49 | 6.25 |
| Netherlands | | | | | | | | |
| All banks | 0.96 | 0.32 | 0.01 | 0.56 | 0.05 | 0.08 | 0.27 | 2.25 |
| Committed banks | 0.26 | 0.21 | -- | 0.10 | 0.01 | 0.02 | 0.08 | 0.68 |
| United Kingdom | | | | | | | | |
| All banks | 3.68 | 8.19 | 1.63 | 6.39 | 1.38 | 1.11 | 1.94 | 24.32 |
| Committed banks | 3.22 | 4.57 | 0.79 | 4.44 | 1.21 | 0.78 | 1.26 | 16.27 |
| Switzerland | | | | | | | | |
| All banks | 1.34 | 1.84 | 0.52 | 1.74 | 0.07 | 0.08 | 0.85 | 6.44 |
| Committed banks | 1.24 | 1.52 | 0.39 | 1.57 | 0.06 | 0.05 | 0.75 | 5.58 |
| Japan | | | | | | | | |
| All banks | 4.48 | 8.80 | 1.16 | 11.14 | 2.69 | 0.66 | 3.16 | 32.09 |
| Committed banks | 3.48 | 7.60 | 1.05 | 9.95 | 2.30 | 0.43 | 2.74 | 27.55 |
| United States | | | | | | | | |
| All banks | 10.14 | 18.78 | 5.34 | 24.06 | 6.39 | 1.91 | 6.88 | 73.50 |
| Committed banks | 9.63 | 17.84 | 5.08 | 22.86 | 6.07 | 1.82 | 6.53 | 69.83 |
| Total of above | | | | | | | | |
| All banks | 25.97 | 47.36 | 9.86 | 52.57 | 12.00 | 5.36 | 15.63 | 168.74 |
| Committed banks | 19.63 | 35.03 | 7.85 | 41.50 | 10.20 | 3.48 | 12.21 | 129.95 |
| France, other banks (if assumed fully committed) | 1.28 | 3.74 | 0.30 | 3.69 | 0.70 | 0.55 | 1.19 | 11.43 |
| Canadian banks (if assumed fully committed) | 1.78 | 5.37 | 0.80 | 4.91 | 0.86 | 0.40 | 1.39 | 15.51 |
| Total of above | | | | | | | | |
| A All banks | 27.75 | 52.73 | 10.66 | 57.47 | 12.86 | 5.76 | 17.01 | 184.25 |
| B Committed banks | 22.69 | 44.13 | 8.95 | 50.09 | 11.76 | 4.43 | 14.79 | 156.84 |
| C Total bank debt | 30.00 | 55.28 | 12.15 | 64.52 | 14.42 | 6.82 | 21.20 | 204.39 |
| A/C (in percent) | 92.50 | 95.38 | 87.70 | 89.18 | 89.18 | 84.40 | 80.24 | 90.10 |
| B/C (in percent) | 75.64 | 79.82 | 73.60 | 77.65 | 81.50 | 65.00 | 69.73 | 76.53 |

# Office Memorandum

NW

Memorandum for Files

December 13, 1985

Subject: Meeting with Bankers on Baker Initiative

On Wednesday, December 4, 1985 the Deputy Managing Director and I met with Mr. Ulrich Merten (Senior Vice President, Bank of America), Mr. Anthony L. Furr (Group Vice President, Wachovia Bank), and Mr. Ashley Jenner (Bank of America) to discuss their preliminary ideas concerning the use of trust funds as a means to facilitate participation in new money packages by banks with small exposures. They indicated that they were a subgroup of the expanded G-14 banks and that they were preparing a study on the use of trust funds for completion by January 1986. They were visiting Washington to seek the views on this subject of the Fund, World Bank, and U.S. banking supervisors.

The bankers outlined their initial thoughts on the use of trust funds for the Baker group of countries. They stated that the advantages and disadvantages of a single trust fund, as opposed to country specific trust funds, were still being examined. Although risk diversification favored a single trust fund, they believed that country specific trust funds tended to be preferred by banks perhaps because they preserved the present pattern of exposure. The trust fund envisaged by this subgroup would be administrated by a multinational development bank (MDB) (e.g., World Bank, Inter-American Development Bank). The trust funds would make loans in support of sectoral programs or projects, although some banks wanted to limit activity to project loans. The lender of record would be the MDB and the borrower would be the developing country. The commercial banks would buy subparticipations in the loans as was the case with cofinanced loans with the IADB. In this fashion, the banks hoped to acquire rescheduling protection and timely payment of interest as a result of the preferred creditor status of the MDBs. They also stated that such loans might be eligible for more favorable treatment by bank supervisors.

The Deputy Managing Director welcomed the efforts by banks to explore means to implement the Baker initiative and indicated that there appeared to be different concepts of a trust fund, some of which were quite broad and ambitious. He questioned, for example, whether use of the MDB's preferred creditor status by commercial banks was consistent with the objective of increasing banks' exposure by $20 billion during 1986-88; bank lending protected by DMBs might reasonably be counted as lending by DMBs, rather than by commercial banks. He also expressed concern that there might be charges of a bank "bail out" which could make more difficult the passage of a capital increase for MDBs in Congress or parliaments. The Deputy Managing Director indicated that the sustainability of the preferred status of these trust funds might be jeopardized from two sources. First, it could prove increasingly difficult over time to limit the size of trust funds as more banks pressed for protection. Second, the preferred status may be called into question by those banks whose loans did not receive preferred status, weakening further bank cohesion.

The bankers responded by acknowledging that the criterion for a cut off point for participation in the trust fund was a major and difficult issue. They added, however, that it was their impression that U.S. regional banks and even some sizable U.S. banks, that were under close regulatory supervision, might choose not to participate in traditional new money packages. In particular, some small regional banks were seeking an "honest broker" in their relations with debtor countries and would prefer a MDB to a money center bank. In this regard, Citibank was cited because of its withdrawal from certain developing countries, while urging regional banks to participate in new money packages.

The Deputy Managing Director expressed the view that there may be other features of a trust fund, short of direct or indirect guarantees and cross default arrangements, which might make trust funds a useful tool for bringing into a new money package reluctant banks with small exposure to a debtor country. He wondered whether some bank managers would find it easier to gain approval from their board of directors for lending to a trust fund rather than lending directly to the debtor country. He also questioned whether bank supervisors might view claims on a trust fund differently from claims on the debtor country. The bankers said they planned to talk to bank regulators.

Two other aspects of trust funds were briefly touched on during the meeting. First, U.S. banks viewed as counterproductive trust funds which had features of an "exit bond" or interest capitalization. Potential problems were perceived with the valuation of other loans to the country and with the treatment of income. European banks appeared to be more favorably deposed toward these features than U.S. banks. Second, some thought was being given to an equity option. Such an option might gather greater support than straight debt finance because of increased synergy with domestic customers.

Before leaving the bankers indicated that Brazil may approach its creditor banks for a medium-term loan to refinance amortization payments during 1985-86. Such a restructuring could assume no Fund arrangement, no new money, and that Brazil remained current on its interest payments. The banks appeared reluctant, but did not rule out, providing such a loan. They based this reluctance on the precedent it would set and because, in their estimation, Brazil's present policies would result in a financing gap in 1987.

G Russell Kincaid

G. Russell Kincaid
Assistant Division Chief
International Capital Markets Division
Exchange and Trade Relations Department

cc: The Managing Director
The Deputy Managing Director
Mr. Finch
Mr. Wiesner
Mr. Beza
Mr. Brown

Mr. Finch

# INTERNATIONAL MONETARY FUND

December 13, 1985

TO : Mr. Brown

FROM: C.M. Watson

SUBJECT: Baker Initiative: Commitments

As I suggested earlier, we have adjusted the bank debt levels for each of the seven countries to estimated end-1985 exposure. As a result of this and a further review of the nationality classification of banks and their subsidiaries, the commitment percentage is increased marginally to 76.62 percent. The presentation of the table also now shows the French and Canadian banks as committed.

There are strong reasons for thinking that the Japanese commitment should be viewed as applicable in practice to all Japanese banks (for whom cohesion is a point of honor). Taking that into account, the commitment percentage is now virtually 80 percent.

Attachments

bcc: Deputy Managing Director
Mr. Finch
Mr. Gardner

tblrkl

Table . Commitments to the Baker Initiative
(In billion of U.S. dollars)

| | Argentina | Brazil | Chile | Mexico | Philippines | Yugoslavia | Venezuela (estimated) | Total |
|---|---|---|---|---|---|---|---|---|
| Belgium | | | | | | | | |
| All banks | 0.63 | 0.58 | 0.14 | 1.04 | 0.04 | 0.02 | na | 2.45 |
| Committed banks | 0.04 | 0.11 | 0.01 | 0.13 | -- | -- | na | 0.30 |
| Canada | | | | | | | | |
| All banks ) Committed banks ) | 1.78 | 5.35 | 0.80 | 4.91 | 0.86 | 0.40 | 1.39 | 15.49 |
| France | | | | | | | | |
| All banks ) Committed banks ) | 1.89 | 4.75 | 0.34 | 4.77 | 1.00 | 0.62 | 1.55 | 14.92 |
| Germany, Fed. Rep. of | | | | | | | | |
| All banks | 2.85 | 3.86 | 0.72 | 2.86 | 0.38 | 0.88 | 0.99 | 12.54 |
| Committed banks | 1.15 | 2.16 | 0.50 | 1.37 | 0.27 | 0.31 | 0.50 | 6.26 |
| Netherlands | | | | | | | | |
| All banks | 0.96 | 0.54 | 0.01 | 0.56 | 0.05 | 0.08 | 0.27 | 2.47 |
| Committed banks | 0.26 | 0.21 | -- | 0.10 | 0.01 | 0.02 | 0.07 | 0.67 |
| United Kingdom | | | | | | | | |
| All banks | 3.68 | 8.36 | 1.63 | 6.39 | 1.38 | 1.11 | 1.94 | 24.49 |
| Committed banks | 2.86 | 4.57 | 0.79 | 4.44 | 1.21 | 0.78 | 1.22 | 15.87 |
| Switzerland | | | | | | | | |
| All banks | 1.34 | 1.90 | 0.52 | 1.74 | 0.07 | 0.08 | 0.85 | 6.50 |
| Committed banks | 1.24 | 1.52 | 0.39 | 1.57 | 0.06 | 0.05 | 0.73 | 5.56 |
| Japan | | | | | | | | |
| All banks | 4.48 | 8.80 | 1.16 | 11.14 | 2.69 | 0.66 | 3.16 | 32.09 |
| Committed banks | 3.48 | 7.60 | 1.05 | 9.95 | 2.30 | 0.43 | 2.74 | 27.55 |
| United States | | | | | | | | |
| All banks | 10.14 | 18.64 | 5.34 | 24.06 | 6.39 | 1.91 | 6.88 | 73.36 |
| Committed banks | 9.63 | 17.71 | 5.08 | 22.86 | 6.07 | 1.82 | 6.53 | 69.70 |
| Total of above as of cut off dates (i.e., 1982-83) | | | | | | | | |
| A All banks | 27.75 | 52.78 | 10.66 | 57.47 | 12.86 | 5.76 | 17.01 | 184.30 |
| B Committed banks | 22.35 | 43.99 | 8.95 | 50.09 | 11.76 | 4.43 | 14.73 | 156.27 |
| C Total bank debt | 30.00 | 55.28 | 12.15 | 64.52 | 14.42 | 6.82 | 21.20 | 204.39 |
| A/C (in percent) | 92.50 | 95.48 | 87.70 | 89.07 | 89.18 | 84.40 | 80.24 | 90.17 |
| B/C (in percent) | 75.50 | 79.58 | 73.60 | 77.63 | 81.50 | 65.00 | 69.48 | 76.46 |
| Memorandum item: | | | | | | | | |
| Total adjusted to end-1985 levels of bank debt | | | | | | | | |
| A All banks | 27.75 | 65.23 | 14.12 | 67.82 | 13.64 | 6.26 | 17.01 | 211.83 |
| B Committed banks | 22.35 | 54.37 | 11.85 | 59.11 | 12.47 | 4.82 | 14.68 | 179.65 |
| C Total bank debt | 30.00 | 68.32 | 16.10 | 76.14 | 15.30 | 7.42 | 21.20 | 234.48 |
| A/C (in percent) | 92.50 | 95.48 | 87.70 | 89.07 | 89.18 | 84.40 | 80.24 | 90.34 |
| B/C (in percent) | 75.50 | 79.58 | 73.60 | 77.63 | 81.50 | 65.00 | 69.25 | 76.62 |

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Memorandum Morgan Guaranty Trust Company of New York

202-623-4661
7491

cc: M. Watson

**The Morgan Bank**

MORGAN BANK FACSIMILE (TELECOPIER) SYSTEM

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MR. WHITTOME
VAN HOUTVEN
MR. MOHAMMED
MR. R. BROWN
MR. NICOLETOPOULOS

TO: Mr. Jacques de Larosiere
Managing Director
International Monetary Fund
BANK/COMPANY NAME

FROM: Lewis T. Preston
Chairman of the Board
Morgan Guaranty Trust Co.
DEPARTMENT

TIME SENT: ______

PAGES SENT: ______
(Excluding Cover Sheet)

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Morgan Guaranty Trust Company of New York 23 Wall Street, New York NY 10015

Lewis T. Preston
Chairman of the Board

Telephone 212 483-3770

**The Morgan Bank**

December 11, 1985

Mr. Jacques de Larosiere
Managing Director
International Monetary Fund
700 19th Street, N.W.
Washington, D.C. 20431

Dear Mr. de Larosiere:

I thought you would like to know that today I wrote to Secretary Baker to advise him of the positive responses the U.S. Consultative Group of banks is receiving. The U.S. Consultative Group was formed to coordinate the response of the U.S. banks to the international debt program Secretary Baker set forth at the annual meetings of the International Monetary Fund and the International Bank for Reconstruction and Development to foster sustained growth in the developing countries.

We are in contact with U.S. banks that have loans to one or more of the countries noted in the proposal. Banks representing more than 95% of loans to the 15 countries have responded to date and have indicated that they welcome Secretary Baker's initiative as a positive and constructive development. Furthermore, the banks confirm their willingness to play their part on a case-by-case basis, provided that all other parties, governmental, institutional, and banking, do the same. In due course we expect to receive additional indications of support from other U.S. banking institutions.

We believe that the response reflects the willingness of the U.S. banking community to work closely with you and others who will be involved in this important cooperative effort.

Sincerely,

Lewis T. Preston

From: U.S. Consultative Group
By: Morgan Guaranty Trust Company
23 Wall Street
New York, NY 10015
(212) 208-3690

December 11, 1985

FOR IMMEDIATE RELEASE

United States banks today declared their support for the international debt program proposed by U.S. Treasury Secretary James A. Baker III to foster sustained growth in the developing countries.

"Banks representing more than 95% of loans to the 15 countries have responded to date and have indicated that they welcome Secretary Baker's initiative as a positive and constructive development," stated letters to the Secretary of the Treasury, the International Monetary Fund and the World Bank from the U.S. Consultative Group, which was formed to coordinate the response of U.S. banks to the Baker proposal.

The letters, signed by Lewis T. Preston, chairman of Morgan Guaranty Trust Company, in his capacity as chairman of the group, said: "We are in contact with U.S. banks that have loans to one or more of the countries noted in the proposal, and they confirm their willingness to play their part on a case-by-case basis, provided that all other parties, governmental, institutional, and banking, do the same."

The letters also said: "We believe that the response reflects the willingness of the U.S. banking community to work closely with you and others who will be involved in this important cooperative effort."

The U.S. Consultative Group said it is continuing to discuss the program with other banks and expects further indications of support.

# # #

# WITHDRAWAL NOTICE

## PROJECT

| | |
|---|---|
| Project number | 2008-012 |
| Project name | PDR/EXR Front Office (AI) |
| Project tab number | 380 |
| Project box number | 4 |

## DOCUMENT

| | |
|---|---|
| Series / File | Baker Debt Initiative (36544) |
| Original box / file No | 2 / 5 |
| Date | 1985-12-31 |
| Type | Cable |
| From | Khalid S. Bin Mahfouz |
| To | Jacques de Larosiere |
| Subject / Title | I am pleased to inform you that representatives of four saudi... |
| Number of pages | 1 |
| Classification | SECRET |
| Authority | Office of Executive Director for Saudi Arabia |

## COMMENTS

**THIS DOCUMENT IS IN THE COURSE OF A SYSTEMATIC PUBLIC DISCLOSURE REVIEW PROCESS**

Entered by bhooten Entered on 2008-11-13 cc: Mr. Watson

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EXCHANGE & TRADE RELATIONS
DEC 13 1985

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GAD-141 (URG)
FROM THE BANK OF TOKYO LTD TOKYO DATED DECEMBER 12, 1985
FOR AND ON BEHALF OF THE BELOW-MENTIONED INSTITUTIONS

ORIG: MD
CC: DMD
MR. FINCH
MR. HOOD
MR. HABERMEIER
MR. NICOLETOPOULOS
MR. VAN HOUTVEN
MR. WHITTOME
MR. MOHAMMED
MR. R. BROWN

TO: MR. JACQUES DE LAROSIERE
CHAIRMAN OF THE
EXECUTIVE BOARD
AND MANAGING DIRECTOR
INTERNATIONAL MONETARY
FUND
WASHINGTON, D.C.20431
U.S.A.

TO: MR. A.W. CLAUSEN
PRESIDENT
INTERNATIONAL BANK FOR
RECONSTRUCTION AND
DEVELOPMENT
1818 H. STREET, N.W.
WASHINGTON, D.C. 20433
U.S.A.

GENTLEMEN:

THE FOLLOWING JAPANESE BANKS GATHERED IN TOKYO THIS WEEK AND DISCUSSED INTENSIVELY THE PROPOSALS MADE BY THE HON. JAMES A. BAKER, III, SECRETARY OF THE TREASURY AND GOVERNOR OF THE BANK AND THE FUND FOR THE UNITED STATES AT THE ANNUAL MEETINGS OF THE IMF AND IBRD IN SEOUL.

WE ARE VERY WELL AWARE OF MR. BAKER'S PROPOSALS AND WE ARE ALSO AWARE OF THE SUPPORT FOR THE PROPOSALS GIVEN BY THE GOVERNORS OF THE CENTRAL BANKS OF THE GROUP OF 10. WE ALSO WELCOME MR. BAKER'S INITIATIVE AS A POSITIVE AND CONSTRUCTIVE APPROACH AND CONFIRM OUR WILLINGNESS TO CONSIDER A CONTRIBUTION ON A CASE-BY-CASE BASIS, PROVIDED THAT ALL OTHER PARTIES: DEBTOR GOVERNMENTS, CREDITOR GOVERNMENTS, INTERNATIONAL INSTITUTIONS AND OTHER FINANCIAL INSITUTIONS, DO THE SAME.

VERY SINCERELY YOURS,

THE BANK OF TOKYO, LTD.
THE BANK OF YOKOHAMA, LTD.
THE DAI-ICHI KANGYO BANK, LIMITED
THE DAIWA BANK, LIMITED
THE FUJI BANK, LIMITED
THE HOKURIKU BANK, LTD.
THE INDUSTRIAL BANK OF JAPAN, LIMITED
THE LONG-TERM CREDIT BANK OF JAPAN, LIMITED
THE MITSUBISHI BANK, LIMITED
THE MITSUBISHI TRUST AND BANKING CORPORATION
THE MITSUI BANK, LIMITED
THE SANWA BANK, LIMITED
THE SUMITOMO BANK, LIMITED

INCOMING CABLE/TELEX

THE TOKAI BANK, LIMITED

THE FOLLOWING BANKS HAVE PROPOSED TO PUT THEIR NAMES ON THIS STATEMENT.

THE HOKKAIDO TAKUSHOKU BANK, LTD.
THE KYOWA BANK, LTD.
THE NIPPON CREDIT BANK, LTD.
THE SAITAMA BANK, LTD.
THE TAIYO KOBE BANK, LIMITED

+++
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REPLY VIA ITT

?
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INCOMING CABLE/TELEX

cc: Mr. Guitian
Mr. Watson

INTERNATIONAL MONETARY FUND
WASHINGTON, D. C. 20431

MANAGING DIRECTOR

CABLE ADDRESS
INTERFUND

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DEC 9 - 1985
EXCHANGE & TRADE RELATIONS

December 6, 1985

To: Mr. Clausen

From: J. de Larosière Larosière

As an expression of the broad support for Secretary Baker's debt initiative to which we referred in our statement earlier this week, I am enclosing the text of remarks that I made in summing up a recent discussion by the Executive Board dealing with this matter. Owing to the need for concerted efforts with respect to the debt strategy, these remarks may be also of interest to the Executive Directors and senior staff of the World Bank.

Enclosure (Summing up of Board Meeting EBM/85/166 of Nov. 13, 1985 - Int. Cap. Markets)

# *Office Memorandum*



To: The Managing Director
The Deputy Managing Director

December 5, 1985

From: C. David Finch

Subject: Mr. Clausen's Speech in Buenos Aires

This note features the main weaknesses we perceive in Mr. Clausen's speech which we would hope could be met by some modifications at least in the delivered text. In making these comments, we would not want overlooked the many very helpful statements--notably on the importance of exports and of trade liberalization.

The most important issue is the absence of a clear statement stressing that the efforts to stabilize the economy and eradicate inflation are necessary preconditions for the restoration of growth. The brief and somewhat incidental mention made on page 2 is not sufficient, particularly since it follows a statement that the process is unsustainable over an extended period of time. This oversight is particularly unfortunate in a speech delivered in Argentina at a critical time for the program. Indeed, the speech could give comfort to opponents of the official strategy in the bald statement that "vigorous adjustment efforts made in Latin America have been largely at the expense of growth" (page 12).

The second most important weakness is the wild exaggeration of the scale of new resources ("...we are talking about a quantum leap in resource availability...." (page 18)) which necessarily limits the attention to the mobilization of domestic resources and adds to pressures for expenditure increases.

Finally, with regard to what has been achieved so far in dealing with the debt crisis, the speech is excessively deprecatory. There is even a hint that the role of the Fund should be lessened when the limiting word "often" is used in relation to the future Fund role. As a minimum, this word could be dropped. Hopefully, some additions could be made stressing the progress made toward achieving the right posture.

cc: Mr. Beza
Mr. Brown

Mr. Finch

17

# Office Memorandum



TO: The Managing Director
The Deputy Managing Director

DATE: December 5, 1985

FROM: S. T. Beza DJB

SUBJECT: Mr. Clausen's Buenos Aires Speech

I have several difficulties with the speech.

1. On pages 2-4, the speech indulges in hand-wringing over developments that no one can change. In respect of the period 1982-84, the speech refers to sacrifices that cannot be sustained, restraints on imports, neglible per capita income growth, austerity measures not permitting economic activity to keep pace with labor force growth, declines in the standard of living that are not acceptable, etc. This collection of phrases gives a misleading message. The fact of the matter is that domestic expenditure had to be brought down in relation to income from the level of the late 1970s-early 1980s in the heavily indebted countries, and this fact will not change. In time, with good policies that promote output growth, domestic expenditure will rise again, but it will have to be more nearly "earned" than in the past period just mentioned. Incidentally, the last sentence of the first full paragraph of page 2 (the sentence praising the Argentine authorities) would need to be developed on its own--it does not fit with the material surrounding it.

2. Pages 5-6 refer to a disappointment about economic prospects for the heavily-indebted Latin American countries, followed by an indication that the Bank never thought the debt problem could be solved overnight (who did?), but then followed by a confession that the Bank overestimated what would be forthcoming in voluntary capital flows and underestimated the degree of suffering there would be until a (satisfactory) growth path was reached. These passages are damaging in that they suggest that a smooth road was in sight but it has now turned to be much more treacherous. For example, we did not think that significant voluntary new credits from the banks would become available to Brazil and Mexico in 1985 and 1986 (in fact in 1984 the authorities of these countries started to play down their external financing requirements).

3. On pages 8-10, the speech falls into the trap of referring to debt-service obligations as drains ~~as~~ on domestic savings, the problem of the debt-overhang sitting as a dead-weight on the shoulders of the heavily indebted countries, and savings that might finance productive investments being mortgaged to meet debt servicing obligations. Put so insistently, it would not be surprising if the debtor countries were to respond that part of the debt should be forgiven.

4. On page 12, there is an unfortunate reference to vigorous adjustment efforts made in Latin America having been largely at the expense of growth.

5. On page 18, line 4, I would suggest that "often" be deleted. The absence of "often" would not mean "always", but the presence of "often" will raise questions.

6. On page 18, the second full paragraph is clearly an overstatement in referring to a quantum leap in resource availability to support new programs. Such a presentation is not in line with the proposals that have been advanced.

7. On a few other points: (p. 14) it is not prudent to say that this group of countries has been too dependent on commodities (they often have penalized primary production as the Bank is very much aware) and to suggest that manufactured exports should be encouraged; (p. 17) the last two paragraphs of this page seem to me to be too mechanical in dwelling on projections of macroeconomic variables, and thus do not give adequate attention to the policies needed for sustained economic growth.

cc: Mr. Finch/Mr. Guitian
Mr. Brown

Mr. Erb

THE WORLD BANK
Washington, D. C. 20433
U.S.A.

Mr Beza

Mr. Finch ✓

A.W. CLAUSEN
President

The Managing Director would like you to look at this and let him know by Thursday December 5 if there is anything to which we would object and which he should raise with Mr. Clausen

RMB 12/4

December 3, 1985

Dear Jacques:

Enclosed is a copy of my speech which will be delivered next Monday in Buenos Aires. As I mentioned to you, it describes the debt problem and discusses the importance of resumed growth for reducing the debt servicing ratio. It also describes the impediments to resumed growth and outlines the concerted actions required by all participants to make sustainable growth a reality.

Warm regards.

Sincerely,

Tom

Mr. Jacques de Larosiere
Managing Director
International Monetary Fund
IMF 12-300C

Weak on domestic causes of current difficulties. Exaggerates scale of new resources [illegible] relative to needed domestic efforts

RECEIVED
DEC 5 1985
EXCHANGE & TRADE RELATIONS

cc World Bank: for Copy to ① Mr. Erb ② Mr. Finch ③ Mr. Guitian ④ Mr. Beza ⑤ Mr. Goldstein

-WORLD BANK PRESIDENT OUTLINES STEPS DEVELOPING NATIONS MUST UNDERTAKE TO BREAK OUT OF DEBT CRISIS

WASHINGTON-(DJ)--WORLD BANK PRESIDENT A.W. CLAUSEN MONDAY OUTLINED THE POLICY ACTIONS THAT THIRD-WORLD DEBTOR NATIONS MUST UNDERTAKE IF THEY EXPECT TO GET NEW LOANS AND OTHER INTERNATIONAL CAPITAL FLOWS TO HELP PUT THEIR ECONOMIES ON A PATH TO SUSTAINED GROWTH.

IN A SPEECH PREPARED FOR DELIVERY IN BUENOS AIRES, CLAUSEN SAID THE WORLD BANK "IS READY AND ANXIOUS" TO PLAY A MAJOR ROLE IN ASSISTING THE DEBTOR NATIONS.

BUT CLAUSEN ALSO STRESSED, IN CONSIDERABLE DETAIL, WHAT HE CALLED THE KEY FEATURES OF THE ECONOMIC PROGRAMS THAT THE HIGHLY-INDEBTED NATIONS NEED TO UNDERTAKE, IF THEY ARE TO GET NEW LOANS FROM COMMERCIAL BANKERS AND INTERNATIONAL LENDING AGENCIES.

SUCH PROGRAMS, HE SAID, MUST ENABLE EACH COUNTRY "TO ACHIEVE A REASONABLE RATE OF GROWTH AND SUBSTANTIALLY REDUCE ITS DEBT-SERVICE RATIO TO A SUSTAINABLE LEVEL BY A SPECIFIC DATE."

"EACH PROGRAM," HE CONTINUED, "SHOULD FIRST SET FORTH A FEASIBLE AND ATTAINABLE TIME PATH OF KEY AGGREGATE VARIABLES, EXPORTS, IMPORTS, SAVINGS, INVESTMENT AND GROSS NATIONAL PRODUCT OVER THE MEDIUM-TERM. IT SHOULD SPELL OUT THE GROWTH RATE OF THESE KEY VARIABLES THAT ARE JUDGED FEASIBLE, AND THAT PERMIT A GRADUAL RESTORATION OF SUSTAINABLE DEBT-SERVICE RATIOS BY THE END OF THE PERIOD. AND THE CAPITAL FLOWS ESSENTIAL TO THE FOLLOWING OF THIS PATH WILL NEED TO BE ESTIMATED."

WHILE THE ECONOMIC PROGRAMS WILL VARY FOR INDIVIDUAL DEBTOR COUNTRIES, CLAUSEN SAID "THE PROGRAMS SHOULD SPECIFY THE POLICY MEASURES NECESSARY TO ACHIEVE THEIR OBJECTIVES."

DEVELOPING SUCH GROWTH-ORIENTED COUNTRY PROGRAMS, CLAUSEN SAID, "WILL OFTEN N

/ / /

-(DJ-12-09-85 1953GMT)

It transpires that the copy we were sent came to us after the embargoed copies had been released

Cooly B

12/10

CLAUSEN ALSO EXPRESSED CONCERN OVER THE SLOW RESPONSE FROM COMMERCIAL BANKERS TO THE PROPOSAL PUT FORWARD BY U.S. TREASURY SECRETARY JAMES BAKER IN EARLY OCTOBER FOR STEPPED-UP LENDING BY COMMERCIAL BANKS AND SUCH AGENCIES AS THE WORLD BANK TO DEVELOPING COUNTRIES THAT AGREE TO CARRY OUT NECESSARY ECONOMIC ADJUSTMENT EFFORTS.

HE EMPHASIZED THAT ALL PARTICIPANTS IN THE NEW THIRD-WORLD "DEBT STRATEGY" HAVE TO MOVE AHEAD AT THE SAME TIME WITH "CONCERTED" ACTIONS.

THESE "ARE NOT SEQUENTIAL ACTIONS," HE ADDED.

SO FAR, CLAUSEN SAID, THERE ARE "FEW SIGNS OF A RESUMPTION OF VOLUNTARY COMMERCIAL BANK LENDING" TO THE THIRD-WORLD DEBTOR NATIONS.

CLAUSEN, WHO WENT TO SOUTH AMERICA LAST WEEK TO CONFER WITH GOVERNMENT OFFICIALS AND BUSINESS LEADERS IN URUGUAY, ARGENTINA AND AND ECUADOR, SAID THAT LATIN AMERICAN DEBTOR COUNTRIES MADE REMARKABLE PROGRESS IN THE 1984-1985 PERIOD IN REDUCING THEIR CURRENT-ACCOUNT INTERNATIONAL PAYMENTS DEFICITS.

HOWEVER, THE WORLD BANK OFFICIAL SOME THINGS HAVE "GONE WRONG" AND TODAY THERE APPEARS TO BE GROWING CONCERN ABOUT THE GROWTH PROSPECTS FOR LATIN AMERICAN COUNTRIES..

"SUCH DOUBTS," CLAUSEN SAID, "ARE LARGELY ENGENDERED BY A REALIZATION THAT THE RESUMPTION OF GROWTH, WHICH IS ABSOLUTELY ESSENTIAL IN THE HEAVILY-INDEBTED COUNTRIES, CANNOT TAKE PLACE WITHOUT ADEQUATE RESOURCES TO SUPPORT THE INCREASING INVESTMENTS AND CONTINUING POLICY REFORMS WHICH ARE NEEDED TO SECURE THAT GROWTH ON A SUSTAINED BASIS. BUT THE AVAILABILITY OF THESE RESOURCES IS THREATENED FROM A VARIETY OF QUARTERS, BOTH EXTERNAL AND DOMESTIC."

"AND THAT, HE SAID, "HAS GIVEN RISE TO FEARS THAT EVEN COUNTRIES WHICH HAVE UNDERTAKEN SIGNIFICANT DOMESTIC ADJUSTMENTS MAY GET CAUGHT IN THE LOW INVESTMENT-LOW GROWTH TRAP.

" WE MUCT ACT TOGETHER, NOW, TO PREVENT THAT HAPPENING," CLAUSEN SAID.

-0-

-(DJ-12-09-85 2022GMT)

-WORLD BANK PRESIDENT OUTLINES STEPS -1A-

DEVELOPING SUCH GROWTH-ORIENTED COUNTRY PROGRAMS,
AUSEN SAID, "WILL OFTEN NEED THE COLLABORATION" OF THE
TERNATIONAL MONETARY FUND (IMF) AND HE ADDED THAT THE IMF
ANDS READY TO PROVIDE SUCH ASSISTANCE.

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(DJ-12-09-85 1956GMT)

How come this was [illegible] ?

M. Finch

December 5, 1985



A suggestion for the implementation of the Baker Plan

Among the 15 countries singled out by the Baker Plan to benefit from increased contributions by commercial banks, (the "Banks"), three : Mexico, Brazil and Argentina have started a process of privatization of state-owned enterprises.

The sale of 7 % of Petrobras equity for $ 400 million on the local stock exchange represent the most significant example of this trend.

A greater percentage of Petrobras shares could have been issued if not for the fear of swamping the limited facilities of the exchange.

Hence, the idea to connect this process with the implementation of the Baker Plan.

In the three countries eligible for special treatment because of their privatization policies, the Banks contribution to the Baker initiative could either represent a set percentage of their open claims as in all the other 12 countries and/or take the shape of an equity investment to the same amount.

An Equity Trust Fund (the "Trust") would be set up in each of these countries (Mexico, Brazil and Argentina) in which the monies paid in the Banks would be accrued in local currency at a fixed exchange rate against US$. The domestic currencies thus made available would be used to purchase shares of state-owned enterprises offered on the local stock-exchange.

In recognition of their contribution, the Banks would receive from the Trust, Convertible Investment Certificates (the "Certificates") denominated in local currency with the indication of the rate of exchange against US dollar. These Certificates would bear interest on their nominal face-value at a rate of interest to be determined (these points will have to be studied in detail. Indeed to pay a guaranteed interest in US$ supposes firstly that a way is found to bridge the probable gap between the amount of dividends received by the Trust and the interest charge, secondly that foreign exchange transfer authorizations are automatically granted at the exchange rate indicated on the Certificates).

The Certificates would have a life of seven years after which they would either be redeemed by the countries involved in the scheme, at their nominal face-value, or converted into ordinary shares of the Trust at the option of the Banks (the obvious choice if the value of the Trust has appreciated).

.../...

If a way could be found to give the holders of the Certificates the right to convert into stocks owned by the Trust rather than in shares of the Trust, the value of the Certificates would be enhanced.

The setting up of the Trusts, and the maximum amounts to be paid in annually, will be negotiated, country by country, by the World Bank whose responsibility it will be to manage these Trusts and especially decide which shares of enterprises to be privatized to purchase and in what amount.

Furthermore, the World Bank, to affirm its position as a prime mover in the process of implementation of the Baker Plan and in the enlargement of the private sector in developing countries, may well decide, through specially designed loans, to partially match the Banks contribution to these Funds.

A decision by the World Bank in that direction may prove to be, for the Banks, a strong inducement to choose the equity rather than the debt approach of the Baker Plan.

Pierre Haas

PH/mbp

Office Memorandum

December 2, 1985

MEMORANDUM FOR FILES

Subject: Meetings of the Committee on Financial Markets, November 20-23, 1985

A report on these meetings has been prepared by Ms. Eken of the Paris Office. This memorandum provides additional details focusing on discussions concerning the Baker Initiative.

Both the US and European bankers present welcomed the Baker Initiative as being a timely response to the deterioration in the debt situation which had occurred during the last year. They thought that sustained adjustment efforts would require politically acceptable growth rates in developing countries. Such growth rates could be achieved through comprehensive economic policies, which included both demand management and supply oriented policies, combined with greater lending by official agencies and by commercial banks. For the initiative to succeed, a coordinated effort by all parties was necessary. The U.S. banks, in particular, stressed that the Baker initiative was a political initiative. It therefore needed the political support of both the developing countries and industrial countries. The U.S. banks were concerned, however, that the requisite political support had not yet materialized. In this regard, support by industrial countries for greater lending by multilateral development banks, as well as for a general capital increase at the World Bank, were viewed as important signals of political consensus.

There was an agreement among the banks and the officials that implementation of the Baker initiative should precede on a case-by-case basis. Furthermore, they concurred that conditionality should be associated with the disbursement of any additional lending to the Baker group of developing countries. Bankers in particular welcomed the continued central role of the International Monetary Fund and were encouraged by the proposed expanded role for the World Bank. They however were uncertain how collaboration between the two institutions would work in practice and how banks would link disbursements of their loans to the disbursements by the World Bank and the Fund.

Regarding the design of comprehensive policy programs, bankers saw the Fund providing expertise in the area of demand management, while the World Bank would focus on the evaluation of the investment programs and determine the necessary structural reforms. In discussing structural reforms, bankers expressed concern that implementation of such reforms may prove politically more difficult than the macroeconomic policies recommended by the Fund. In particular, Mr. de Lattre of the IIF noted that structural reforms were often opposed by vested interests which were very important politically.

Additional details on various aspects of the initiative were sought by the participants especially those from Europe and Japan. Some bankers (e.g., U.S., French, and Spanish) questioned whether the amount of $20 billion would be sufficient to finance the targeted growth rates, while other bankers (e.g., German and British) wondered whether that amount was too ambitious in light of the present downward trend in bank lending. Several bankers were also fearful that their endorsement of the Baker initiative could result in even larger requests for bank lending in the future to the Baker group of countries or to an expanded group of countries. Banks, however, seemed less concerned about expansion of the list of countries because they recognized that the present list was not all inclusive. A major issue to many European banks was the distribution of loans among the countries on the list. They thought that the distribution should reflect the varying interests and exposures of the different national banking groups. They were also concerned that large percentage increases in exposure to certain countries (e.g., Mexico and Argentina) might leave meager resources for the remaining countries on the list.

Bankers felt that supervision practices should be adapted to support the Baker initiative. They thought that a conflict existed between the objectives of domestic and international prudential regulation as efforts to improve the soundness of the domestic banking system could result in disincentives for international lending that might undermine the quality of international assets. In this regard, U.S. bankers pointed to the less flexible attitudes of state bank supervisors compared with federal supervisors. This difference in attitude was cited as a factor in the reluctance of small banks in the United States to participate in new money packages. Many banks also thought that bank supervisors could support the Baker initiative by exempting new lending, especially where such lending was cofinanced with the World Bank, from mandatory provisioning requirements. Officials from the G-5 countries indicated that they supported the Baker initiative, but that they were not prepared to alter their supervisory practices. Only two countries (i.e., Netherlands and Canada) exempt at present cofinanced loans with the World Bank from mandatory provisioning requirements. The Netherlands reported that it was considering terminating the special status of these loans because cofinanced loans have been rescheduled.

The lessening of bank cohesion was cited as being an urgent problem that needed to be addressed within the context of the Baker initiative. The growing diversity in banks' attitudes was felt to stem from several factors including long-term business interests, provisioning, and the concentration and level of exposure. On the later point, banks indicated that some banks with small exposures had succeeded in writing down or selling off their claims on certain developing countries. Consequently those banks had little interest in new lending to those developing countries. U.K. and French banks expressed the view that the "small bank" problem was primarily a U.S. problem. Assembling the critical mass for a new money package was less difficult for U.K. and French banks because approximately 90 percent of their exposure to developing countries was concentrated in about half a dozen banks. European and Japanese banks stressed however the need for fair burden sharing across national groups of banks and seemed willing therefore to explore new techniques that promote such equitable burden sharing.

Several techniques for dealing with the problem of banks with small exposures were put forward for discussion during the course of the meetings, but no one technique seemed to gain wide acceptance. First, some U.S. banks suggested the use of country specific trust funds as a means to ensure greater participation in new lending by all sizes and nationality of banks. Such a fund could permit banks with small exposures to avoid formal commitment by their credit committees of new loans to debtor countries. Second, Mr. de Lattre proposed exit bonds be made available to banks with small exposures, but only if these bonds were available at a deep discount. Third, banks in Germany and Spain thought that capitalization of interest would make it easier for banks with smaller exposure to participate by avoiding approval of their credit committees. One objection raised to interest capitalization by U.S. banks was the potential loss of leverage over debtor countries' policies. Without adequate adjustment efforts by the debtor countries, the U.S. banks felt that the debt burden of these countries would only become more onerous and the prospect of prompt servicing of the debt more remote. Fourth, guarantees by the World Bank, such as for Chile, were proposed as a technique. The representative from the World Bank made it clear that the World Bank would not extend guarantees on a large scale, but he did indicate that in certain special cases guarantees could serve a useful role in promoting bank cohesion. The U.S. Treasury representative basically concurred stating that guarantees by the World Bank would be appropriate only in very rare circumstances.

During the meeting the World Bank came under some sharp criticism for certain aspects of its cofinancing program. In particular, some banks expressed dissatisfaction that cofinanced loans had been included in recent restructurings (e.g., the Philippines) and/or new money packages (e.g., Colombia). Moreover, in a number of cases, interest payments to banks with cofinanced loans have been delayed, while interest payments to the World Bank have remained timely. For this reason, some banks were seeking pro rata sharing of interest receipts by the World Bank with commercial banks. Banks also expressed dissatisfaction with continued disbursements by the World Bank to a country even after the country had interrupted serving of its debt to commercial banks. Thus, some banks wanted cross default clauses on cofinanced loans. The impact of greater lending by the World Bank under the Baker initiative on the creditworthiness of the World Bank was also raised by some officials (e.g., the Netherlands and Germany).

G Russell Kincaid

G. Russell Kincaid
Assistant Division Chief
International Capital Markets Division

cc: Mr. Finch (on return)
Mr. Beveridge
Mr. Guitian
Mr. Hino
Mr. Watson (on return)

# INTERNATIONAL MONETARY FUND

FINCH, C. DAVID

ROOM 5-100 11

PRESS RELEASE NO. 85/37

FOR IMMEDIATE RELEASE
December 2, 1985

Statement by the Managing Director of the International Monetary Fund and the President of the World Bank on the Debt Strategy

On the occasion of the Annual Meetings of the International Monetary Fund and the World Bank in Seoul, Korea, in October, the Governor of the Fund and the Bank for the United States, Secretary of the Treasury James A. Baker, III, outlined "a program for sustained growth", an initiative to strengthen the international debt strategy. The essential elements of that initiative could be summarized as: first, the adoption by "debtor countries of comprehensive macroeconomic and structural policies, supported by the international financial institutions, to promote growth and balance of payments adjustment, and to reduce inflation"; secondly, a continued central role for the IMF, in conjunction with an enhanced role for the World Bank and other multilateral development banks reflected in increased and more effective structural adjustment lending; thirdly, "increased lending by the private banks in support of comprehensive economic adjustment programs".

In recent discussions by the Executive Boards of the two institutions broad support was expressed for this debt initiative, which is geared to dealing with the problem in the context of growth and adjustment.

The President of the World Bank and the Managing Director of the IMF wish to express their strong support for the initiative which, given the urgency of the problems, should be translated into positive and concrete actions as soon as possible.

The IMF and the World Bank, in close collaboration, are ready and willing to play their parts in the implementation of the initiative and to that end will cooperate fully and constructively with their membership and with all parties in these concerted efforts to deal with debt problems and establish the basis for sustained economic growth.

1) ~~Mr. ...~~

2) Mr Finch

You will be interested in this version of constructability.

[illegible]

Mr. Eb

# INTERNATIONAL MONETARY FUND

November 22, 1985

TO : The Managing Director

FROM: Leo Van Houtven

You may perhaps have seen the record of the statement made by Mr. Stern on Secretary Baker's debt initiative to the Bank Executive Board on November 12, 1985. Some, but not all Fund Executive Directors have received a copy through their Bank counterpart. The question has been put to me that in transmitting to Mr. Clausen your summing up of the Fund's Board Capital Markets and Baker Initiative discussion, you may perhaps suggest that Mr. Stern's statement be made available to all Fund Executive Directors and senior staff.

Attachment

cc: The Deputy Managing Director
Mr. Brown

# International Bank for Reconstruction and Development

S:60 PH

Debt Justification File

**FOR OFFICIAL USE ONLY**

SecM85-1235

FROM: The Deputy Secretary

November 19, 1985

COMMITTEE OF THE WHOLE MEETING - NOVEMBER 12, 1985

Statement by Mr. Stern

As requested by Executive Directors, attached hereto is a copy of the statement made by Mr. Stern at the meeting of the Committee of the Whole on November 12, 1985.

Distribution:

Executive Directors and Alternates
President
Senior Vice Presidents
Senior Management Council

As you know, Secretary Baker's proposal refers to a list of 15 middle-income countries, (Argentina, Brazil, Chile, Mexico, Venezuela, Nigeria, the Philippines, Bolivia, Colombia, Ecuador, Peru, Uruguay, the Ivory Coast, Morocco, and Yugoslavia). And it was proposed that, for this list of countries, the commercial banks ought to commit themselves to increase their net outstandings by some $20 billion over three years, and that the multilateral development banks should increase their disbursements to these countries by an approximately equal amount over this period. About 60 percent of this would be by the World Bank. I mention these numbers because they are relevant to the comments made in various meetings.

Since the IIF meeting two weeks ago, the commercial banks have established a coordinating committee, representing banks from the United States, Canada, Switzerland, Japan, France, Germany, and the U.K. This committee of approximately 17 banks---and there may be additional members later--- consists of chairmen of the Advisory Committees which have dealt with the rescheduling exercises in the last several years. It is the intention that this group be the principal conduit for negotiations with the U.S. Treasury in formulating the response to Secretary Baker's proposal. This group also wishes to discuss the role of the World Bank and the IMF in individual countries. The IIF would not serve as the channel for these discussions, but might provide technical support to the coordinating committee.

Last week Mr. Erb and I met with the coordinating group in New York. My assessment is that the banks are making good progress in considering how to respond to Mr. Baker's request for a commitment of $20 billion in support of growth-oriented adjustment programs. Thinking is also progressing on how such a commitment might be implemented in individual country cases. Many issues are on the table and, as yet, there are few conclusions. Each group of banks on this committee is to be responsible for contact with their national groups of banks. In the United States that effort is being headed by Morgan Guaranty, which has already convened a meeting of U.S. regional banks to consult with them on how the U.S. banking community might respond to Secretary Baker's request for a commitment.

The non-U.S. banks at the meeting reiterated what they had said at the IIF meeting, namely that they had not yet heard from their governments and hence wanted to wait before considering in detail how to respond. Nonetheless, I think, there is general acceptance of the principle by these banks that in appropriate circumstances---that is, if there is a satisfactory program which both the Fund and the Bank can monitor and a growth-oriented adjustment program designed to enhance the creditworthiness of these countries over the medium-term---that they would be willing to participate in financing such programs.

COMMITTEE OF THE WHOLE MEETING - NOVEMBER 12, 1985

Remarks by Mr. Stern

Excerpts from Transcript of Proceedings

I reported two weeks ago on the initial meeting that was held by the International Institute of Finance to discuss the response of the commercial banks to the proposals made by U.S. Secretary Baker in his address to the Bank Governors in Seoul. Since then, as Mr. Clausen has indicated, there have been a number of other meetings, and we thought it might be useful to bring you up-to-date on those discussions and the work that is in progress in various fora.

All of you are familiar with Secretary Baker's speech in Seoul, which contained the proposal relating to the heavily-indebted middle-income countries. I just want to note, before we turn to the subject, that as Mr. Clausen indicated, the United States has proposed two different initiatives---one, relating to the middle-income countries, and I will turn to that in a moment; and the other relating to low-income countries which revolves around the availability of trust fund resources in the IMF, their use in support of adjustment programs for countries with continued acute balance-of-payment problems and the need to support those countries, in addition to the use of the trust fund resources, with other sources of funds.

Discussions on the latter proposal are also proceeding both in the Fund Board as well as bilaterally. The two proposals rest on the same two basic principles, namely that it is urgent to develop adjustment programs which contain a significant element of growth; and that it will require more external capital if the growth objectives are to be achieved.

We believe that both principles are vital.

Let me now turn to the discussions which have taken place regarding the middle-income countries.

In the middle-income highly-indebted countries, growth in the last several years has been very low. We think that there has been some recovery in 1985 but even so, for the period since the debt crisis started in the early 1980s, there has been a sharp reduction in disposable income; savings rates have dropped, although there is some recovery in 1985; investment programs have been cut substantially, in some cases emasculated, with heavy costs for future growth; and the adjustments which have been undertaken have had a serious impact on real wages and in some cases have led to increases in malnutrition and other manifestations of poverty.

We believe it is correct, as indeed we have argued for some time, that adjustment programs need to do two things: one, move beyond the adjustment measures which have been taken so far; and second, incorporate a significant resumption of growth.

Quite a lot of activity is in progress to expand the consultation with major capital exporting countries. There is a BIS meeting this week in Basel where, no doubt, the opportunity will be taken to discuss the objectives of the Baker proposal and the request for a commitment by the commercial banks.

There also will be two relevant meetings in Paris this week; Working Party III of the OECD which has on its agenda the debt problem and so will be a natural forum for further discussion of this initiative. The Deputies of the G-5 also will meet and are expected to discuss the U.S. proposal and any actions they might take to encourage their national banks to participate.

In addition, I am sure all of you have read that Mr. Mulford, the Assistant Secretary of Treasury, has gone to Argentina to discuss with one of the heavily indebted countries, which is in the middle of a major adjustment program, its reaction to the proposals. He will be followed, I think, either later this week or early next week, by Mr. Volcker, on a similar mission.

We would expect that, after the discussions in Basel and Paris, the non-American banks will be in a better position to judge how they might participate in responding to Mr. Baker's proposal.

At the Friday meeting with the commercial banks, there also was discussion about the list of countries and what it meant, and about how specific the $20 billion was. The general conclusion was that the list will need to be flexible over time. It is, of course, a list of countries which are highly indebted and which need to deal with their adjustment problems. But there may be other countries which should be added, and not all of the countries on the present list may act to formulate an appropriate adjustment program in the near future. But the prevailing view was that the list was a reasonable starting point, although some would, at the margin, have made different choices.

And from that, of course, it follows that the $20 billion commitment requested from the commercial banks is a general objective. While it is very important, in terms of conveying to the countries considering growth-oriented adjustment programs, that resources will be available to finance these programs and this is crucial---the exact amount required will have to be decided in each case.

The discussions also dealt with the nature of the adjustment programs, the nature of Bank/Fund collaboration, and the World Bank support of adjustment programs.

Let me cover these three aspects briefly. The nature of the programs that are implied in Mr. Baker's proposal are programs that we are familiar with in this Board. The changes required are those that we have supported with our structural adjustment lending. And our lending as well as our policy work has had as its objective the resumption of growth. But I think what will be required beyond that is a more systematic approach, a more comprehensive approach, a more integrated approach.

Essentially, these programs should have two objectives: namely, a reduction in the debt service ratio over a period of time, and a development program which is based on a reasonable rate of growth. What a reasonable rate of growth is, and how rapidly the debt service ratio can be reduced will, of course, be determined in the context of each country situation. But both objectives need to be present.

And based on those two objectives, it will be possible to calculate a number of other major objectives; such as growth of exports; investment levels, both public and private; savings levels, expectations as to the budget requirements and so forth. The purpose of the projections would be to identify the policy measures that might be needed to achieve the objectives with a reasonable degree of certainty.

While these objectives, and the associated policy framework, can be defined broadly for a five-year period, they will need to be flexible and subject to regular review. Specific measures for the first year would be agreed. Flexibility to undertake mid-course corrections will be important because there are many changes in the international environment which are likely to occur and which the debtor countries cannot control. And any program with its associated financing package needs to be constructed with the flexibility to respond to unforseen developments, both internal and external.

But essentially, the kind of program framework built around the objectives of growth and enhanced creditworthiness is what we envisage and what is, I think, generally accepted.

In terms of Bank/Fund assessment of these programs, it implies a different approach than in the past in the sense that it will require an earlier assessment of resource availabilities. And that is why the indications of commitments from the commercial banks and from the MDBs is important. In order to formulate a program which has a specific growth objective as well as an objective to reduce the debt service ratio, it is crucially important to have a good understanding of the external resource envelope, as well as of the domestic resource mobilization effort. If one has an assessment of the external resources likely to be available early in the process, it facilitates constructing programs which incorporate an explicit growth objective rather than allowing growth to be calculated as the residual. If, as has occurred in the past, the availability of external resources is unclear at the outset, and one tries to strike the best possible deal in terms of new money packages, there is a risk that the resources for growth are squeezed. So the shift implicit in the Baker proposal is a very important one.

On Bank/Fund collaboration, Mr Erb and I indicated that we did not believe that major changes in the system of collaboration would be necessary. As we have mentioned before, in the last several months the Fund has issued instructions to its staff on collaboration, and we have issued a parallel note to Bank staff. We believe that these two sets of guidelines are adequate. They formalize what has been going on for some time now---effective exchange of views before missions leave, participation in each other's missions whenever appropriate, debriefing upon return of missions and, where we are both engaged in supporting structural adustment programs, an active exchange of views throughout the processing of the Fund's papers on standbys or EFFs, and our processing of structural adustment lending. Obviously, we will need to give further thought to how we can best help develop integrated and comprehensive programs of growth oriented structural change on the basis of which Fund programs and Bank structural adjustment lending or sector adjustment lending could be based.

There are in the minds of commercial banks also, a number of issues relating to their collaboration with the World Bank. They relate to monitoring and to what we can call comfort issues.

On the monitoring side, I think the discussions have been very fruitful. We have been able to point to past activities where the commercial banks and the Bank and Fund have collaborated closely such as Costa Rica, Morocco, Chile and Colombia. There is now a better general understanding that World Bank loans have quite explicit performance objectives, that these are monitored regularly, and the countries concerned have been prepared in the past, and presumably will be in the future, to convey to the commercial banks the results of the assessments by the Bank and Fund of progress on agreed objectives. There probably will be issues in the country context to be worked out but I think at the general level the monitoring issue is no longer acute.

On the matter of comfort for the commercial banks, many questions were raised. While we made considerable progress in developing an understanding of what the nature of our collaboration could consist of, this issue will continue to be explored by the commercial banks.

Secretary Baker's proposal called for an increase in exposure by both the private commercial banks and the multilateral development institutions. That clearly means that the multilateral development institutions should not assume the risk of the increase in exposure which the commercial banks are being asked to undertake. To the extent we provide formal comfort---in the form of guarantees or pari passu sharing arrangements---that would be part of the increase in MDB exposure and not part of the $20 billion increase in commercial bank exposure.

Simply stated, that proposition is almost self-evident but it is by no means fully accepted yet and a lot of discussions still circle around it.

Because the provisioning which has taken place in the U.S. and in other OECD countries is quite different, the U.S. and non-U.S. banks take different views of their risks. This also leads them to take different views of expanding exposure in order to enhance the security of their current outstandings. This, in turn, leads the U.S. banks to be more concerned with additional comfort that the MDBs might be able to extend.

The issue of comfort has been neatly encapsulated in the slogan of "equal partners". That sounds good and it is hard to suggest one does not want to be an equal partner. Nonetheless, we pointed out that equality in a narrow financial sense is neither feasible nor desirable. We tried to explain what our concept of partnership is and I think we made a good deal of progress.

In addition to the basic proposition mentioned earlier, i.e., that it is not the intention that the MDBs take the risk of the incremental exposure of the commercial banks in addition to their own, we have tried to explain that equal partnership has to be seen in the context of what the respective institutions can contribute.

The commercial banks initially defined equal partnership to mean that equal remedial actions should be undertaken in case programs go off the track or delays in debt servicing occur. This meant to them explicit legal linkages to our lending, such as mandatory cross-default clauses. Other aspects would involve sharing of proceeds which would imply that we should give up our preferred creditor status, in case there are delays in debt servicing. And they defined equal partnership to mean that we ought to participate in rescheduling, at least insofar as the additional funds are concerned.

We stressed that this approach misconstrues how the World Bank can be most helpful. The initial approach of the commercial banks essentially suggests that the World Bank and the IDB should behave like commercial banks. The basic point is, of course, that if we do, we will have nothing of value to contribute to the partnership because it eliminates precisely what we bring to this partnership. We are central to the achievement of the objectives of growth oriented adjustment because we are an advisor to the developing countries, seen as reasonably impartial, not representing anyone's interest except that of its members, and with an independent professional judgment. If we lose that reputation and that capacity, then we immediately lose our ability to help countries formulate their programs. And the foundation of the increased security of the commercial banks is precisely in having feasible growth oriented programs of structural change implemented effectively.

We also pointed out that the equal partnership concept, as contemplated by the commercial banks, would not help them very much in financial terms. The current outstandings of commercial banks are about 10 times as large as those of the MDBs together, and in cases of protracted delays in servicing, the servicing of the MDB debt, even if shared, would be an insignificant financial benefit compared to the costs. Similarly, in cases of rescheduling, the inclusion of the MDBs would not affect the financial position of the commercial banks significantly while we, having suspended disbursements, would lose our ability to consult with countries on how the causes for a delay in servicing could be remedied.

There are cases today, and there have been in the past, where the only effective channel of communication has been the World Bank or the IMF. If there is a delay in debt servicing, even in the context of these new adjustment programs, one wants to be able to distinguish the causes. If they require mid-course corrections in the program, and possibly mid-course corrections in the financing plan, it is important that the Bank and the Fund be able to assess that just as they did the original proposals. If the integrity of our independence is undermined, our ability to discuss and negotiate a revised approach with a country is impaired. In such cases, everyone's basic interest is served by having a revised program agreed to.

There can be cases, of course, where a failure to implement the program is within the control of the country and where the country does not want to take remedial action. But those cases do not pose any new policy issues for the Bank. Where we have a structural adjustment loan and the country fails to implement the program, we do not release the second tranche. If this occurs after the release of the second tranche, we do not continue with the next structural adjustment loan.

In short, we emphasized that the policies which are in place should be maintained and used flexibly if the benefit the commercial banks see in association with us—which is the effective implementation of programs to strengthen a country's creditwothiness through increasing its economic growth—are to materialize.

We, of course, also stressed the very important financial implications to us of changes in our perferred creditor status. If we should lose that status, it would adversely affect our ability to borrow in the market and affect our credit rating. It cannot be in the interest of the commercial banks to have a weakened World Bank at a time that we are being asked to play a major role in formulating and monitoring these adjustment programs.

Let me now mention briefly what we are doing internally---aside from going to a lot of meetings: Mr. Clausen already mentioned that we are preparing a paper for the April meeting of the Development Committee. Mrs. Krueger is coordinating that effort in which all parts of the Bank are participating. That paper will focus on the growth prospects of the highly indebted countries and give our assessments of what is feasible with appropriate policy measures.

Mr. Husain is chairing an effort to look at a number of the highly indebted countries and work with the regions, ERS and the Finance staff to see what adjustments in our country strategies and lending programs, may be necessary; what are the opportunities, and what kind of programs may be feasible in what timeframe. This work will be the basis for discussions with our borrowers. Some of these countries are likely to come to the market quite soon and we have defined our work program, taking this into account.

Third, we have established a group consisting of Finance, the Legal Department and the Cofinancing Unit, to work with Operations on the issues being considered by the coordinating group of banks.

I think, Mr. Chairman, that covers the main developments since our briefing two weeks ago. If there are any questions, I would be glad to try and answer them.

Mr. Finch (o/r) ✓ Mr. Guetian
Mr. Berridge

# Office Memorandum

November 20, 1985

MEMORANDUM FOR FILES

Subject: Meeting with Mr. Cheysson

Mr. Cheysson, accompanied by three associates, one being from the EC office in Washington, called on the Managing Director yesterday evening. The Managing Director began by reviewing the results of the Seoul meeting, paying particular attention to Mr. Baker's initiative. He ended by asking whether it would not be possible for the main European countries to make public their joint support of this initiative through some EC forum.

Mr. Cheysson, in a long reply, covered a number of points. He began with the GATT, and emphatically stated that he thought a new round was necessary and that it would have to cover services even if this were done with a light hand so as to induce the support of the LDCs. He was then lavish in his praise for the work done by the Fund on the debt problem and made particular mention of the surveillance function of the Fund and the importance of surveillance being fully used as regards the industrial countries. He also talked around access to financial markets and the problem of the volatility of the exchange rate.

Subsequently, Mr. Cheysson went on to discuss the importance for the world and also for the United States of countries other than the United States having a satisfactory rate of growth and said that he thought that one reason for the seeming reluctance of European Governments to support Mr. Baker's initiative was to avoid opening themselves to a series of requests for special support from their banks.
Mr. Cheysson also touched on the role of the IBRD and said that he hoped that their involvement could take a form that would support further lending by commercial banks. He said that he thought that the two main areas on which the European Governments could take steps that would reassure their banks, were in the fields of export credits and MIGA. He talked in terms of a package of measures being announced by the European Governments and said that it might be possible for the Commission at a meeting of the Council of Europe early next year to get political support for the Heads of Governments to the Baker initiative. Even if this timetable slipped it would surely be possible in the technical meetings that would precede the Tokyo summit to have the position looked at again in the context of a somewhat broader group of countries.

Lastly, Mr. Cheysson mentioned the possibility of the IIF fostering a trust fund that would take care of the exposures of the smaller banks and raised a query on the policies that might be needed to prevent further capital flight in the debtor countries. In regard to the trust fund notion, the Managing Director strongly emphasized the need to keep the commercial banks in the game saying that they were still a vital player. He also stressed that he thought any form of special guarantee should be avoided. As regards capital flight, the Managing Director expressed skepticism about the effectiveness of controls and stressed instead the importance of fundamental economic policies, such as exchange and interest rates.

L.A. Whittome

cc: Mr. Guitian
Mr. Brown

THE SECRETARY OF THE TREASURY
WASHINGTON

November 20, 1985



cc: Mr. Guitton
Mr. Watson

Dear Jacques:

Please accept my belated thanks for your personal note outlining your views on how to involve the commercial banks in dealing with the LDC debt problem. I understand that David Mulford has discussed with you the ideas in your paper.

As you know, Paul Volcker and I have been meeting with U.S. bankers, and the views they have expressed are quite consistent with the reactions you obtained from the European financial community. We have also been working closely with other major industrial countries to obtain the indications of support from other governments which non-U.S. banks consider necessary before committing themselves to the program.

In this connection, I was pleased by the statements made to the press by the G-10 Central Bankers following the recent BIS meeting. I understand that the IMF Executive Board recently discussed the U.S. proposals and that there was broad support for the initiative. I am hopeful that other governments will also provide a clear signal of support as a result of the latest meetings of the OECD WP-3 and the G-5 Deputies. These expressions of support will give further momentum to the proposal.

I believe good progress is being made by the banks on a public pledge of support, although it may take some more time to develop the specific arrangements to meet these commitments. In this context, I appreciate the banks' desire to have as wide participation as possible, in order to achieve equitable burden sharing among banks and countries. While some form of pooling arrangement may be needed to deal with those banks that prefer to participate indirectly in new lending and increasing exposure, that is basically a matter for the banks to decide. I certainly agree with you on the need to avoid grandiose and overly ambitious schemes.

The willingness of the banks to provide new loans depends importantly on the borrowers' implementing comprehensive growth-oriented economic programs supported by the international institutions. As you know, David Mulford has just visited Argentina and it is my understanding that the government is interested in taking advantage of the Program for Sustained Growth at an early stage, and would be prepared to consider such a program as part of the next phase in its adjustment effort. It will be important for the IMF and the MDB's to position themselves to encourage and support these efforts.

More generally, I believe it is important that the Fund give active consideration as to how it can best give greater emphasis to structural reforms while preserving the basic focus on macroeconomic policies. It appears to me that the upcoming Executive Board review of IMF programs and conditionality will provide an excellent opportunity to move ahead in that direction.

I appreciate the leadership you have shown, Jacques, in helping build a consensus in support of this effort, and look forward to continuing to work closely with you as the program develops.

Sincerely,

Jim

James A. Baker, III

Mr. J. de Larosiere
Managing Director
International Monetary Fund
Washington, D. C. 20431

# WITHDRAWAL NOTICE

## PROJECT

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| Project number | 2008-012 |
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## DOCUMENT

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| Series / File | Baker Debt Initiative (36544) |
| Original box / file No | 2 / 5 |
| Date | 1985-12-02 |
| Type | Cable |
| From | Swiss Bank Corporation General Management |
| To | Jacques de Larosiere |
| Subject / Title | Computer Message No Dialog - As you are aware, the banking community is now engaged... |
| Number of pages | 4 |
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| Authority | Office of the Executive Director of Switzerland |

## COMMENTS

## THIS DOCUMENT IS IN THE COURSE OF A SYSTEMATIC PUBLIC DISCLOSURE REVIEW PROCESS

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Mr. Finch

# Office Memorandum

NM

Memorandum for Files    November 15, 1985

Subject: Meeting with Bankers on U.S. Debt Initiative

A meeting of 15 banks was held in New York on November 7 and 8 to discuss the Baker initiative. For much of the meeting on November 8, Messrs. Stern and Bock from the World Bank, Mr. Curtin from the IDB, and the Deputy Managing Director and myself from the Fund were present. It was stressed that this group of banks, while virtually identical to the G-14, was an ad hoc body formed to examine the nature of a response to the Baker initiative by the international banking community. Some additional banks (including a second Japanese bank) may join in due course.

The tone of the meeting was generally positive. The presentations by the Deputy Managing Director and Mr. Stern on country policies and on cooperation with the multilateral institutions were well received. The central importance of policies aimed at restoring sustainable growth was fully endorsed by the group. As regards the financing side, these banks appeared to be looking at the Baker proposal in a constructive manner. The U.S. banks apparently had circulated a very preliminary draft memorandum to the group on November 7, but there did not appear to be an agreement yet on the form that any commitment by the banking community should take. The earlier proposal that the Fund and the Bank should seek a general commitment from all banks on behalf of the international community was not raised.

The main points that emerged from the session were as follows:

1. A number of banks (especially the French) were very troubled by the list of 15 countries, and there was some questioning whether the figure of $20 billion made sense in economic terms. As the meeting progressed, views appeared to converge on the suggestion by the Deputy Managing Director that the essence of the Baker initiative was a process--one involving cooperation by all the players in their own self interests--to assure that adequate financing was available for countries pursuing appropriate economic policies. There seemed to be acceptance that the list of countries was, in some respects, illustrative, but that the amount of $20 billion for these countries did provide a benchmark for the scale of financing that might be involved if countries' policy performance proved satisfactory. The Deputy Managing Director expressed the view that $20 billion was probably a minimum amount, but stressed that it would be wrong to see the $20 billion in terms of a maximum or a minimum in the sense of a limit or entitlement; the key issue was how well additional financing would be used. Mr. Stern gave the impression that $20 billion was something of a minimum amount; Mr. Curtin said that a three-year period was too short.

2. There was a common view that, once a general understanding between the players had been reached, the initiave should be implemented strictly on a case-by-case basis. The financing appropriate for each country would be determined on the basis of the country's economic policies and prospects and debt servicing potential.

3. As regards the role of the various parties, the Deputy Managing Director and Mr. Stern stressed that radical changes in the approach of the Fund and the Bank were not contemplated. Models for cooperation had been developed, collaboration would continue to be strengthened, and experience was being gained in cases where commercial banks were linking their disbursements to sector policy reforms supported by the World Bank as well as macro-policy programs supported by the Fund. As regards the Fund, banks appeared to be reassured that scope existed for the Fund to provide additional financial support in most cases. However, the World Bank again came under strong pressure to provide financial protection for new lending by commercial banks through guarantees, participation in World Bank loans, or, particularly, cross-default clauses. Mr. Stern, supported by the Deputy Managing Director, countered this suggestion forcefully. He pointed out that excessive rigidities in the system could result in the dialogue with countries breaking down, and that the Baker initiative related, in any case, to the unguaranteed portion of banks' exposure. Toward the end of the meeting, some banks (Chase, Deutsche) were coming to a more statesmanlike position, arguing that legalities were not the heart of the matter: the essence of their concern was to have a more general understanding that debtor countries would not be allowed to drive a wedge between the lenders to the detriment of the commercial banks.

4. There was a general view that, in cases where concerted lending was necessary, banks with small exposures should be called upon to contribute. Participation should involve all banks, without exemptions based on size or other criteria. The problem of modalities was receiving attention, but without a great deal of progress so far. Morgan (Preston) had held a meeting with U.S. regional banks on November 4, but the main thrust of that discussion had been the desirability of affording protection to banks with small exposures through World Bank financial involvement. Manufacturers Hanover favored approaching all banks in the same way as in the past, and introducing flexibility at a later stage, if necessary. The Germans favored some flexibility as regards the type of instrument, but stressed that any option that penalizes nonparticipating banks would effectively need support from national authorities. It appears likely that a subgroup will be set up to study this issue.

5. As regards next steps, there was a general recognition that all parties should try to make progress in parallel. At the same time, there were signs from the French and Swiss, in particular, that they thought the United States needed urgently to "internationalize" the initiative, using Basle, WP3, and the G-5 meeting to begin this process. The U.K. banks also stressed this general point, but mainly with

regard to a need for the U.S. authorities to spread the network of contacts outside the G-10 to Arab, Scandinavian, and Spanish banks. The Germans are not encouraging greater involvement by their government (but admit, in parenthesis, that they cannot yet get any clear reading from the Bavarian banks). The Germans also stressed that the Fund and the Bank could help "depoliticize" the implementation of the initiative and place it on a professional footing. The Deputy Managing Director noted that the Fund would be having contacts with most of the debtor countries during the next few weeks. He cautioned against waiting for a grand, detailed plan to emerge. The key was to respond to each case in a practical way, avoiding any grandiose financing ambitions, and to build on existing experience in a cooperative spirit. In this regard, the Fund was ready to play an active role.

In sum, key positive features of the meeting were the generally positive tone, the commitment to a case-by-case approach, and quite a good understanding of the contribution that could be sought from the Fund. But it has to be borne in mind that this group comprises those banks with the most to lose if the initiative were seen to fail. Even leaving aside the question of adequate policy reforms in debtor countries, clear worries remain on the financing side. These include the problem of banks with small exposures and the continuing strong pressure for financial protection from the World Bank.

C. M. Watson
Division Chief
International Capital Markets Division
Exchange and Trade Relations Department

cc: The Managing Director
The Deputy Managing Director
Mr. Finch (o/r)
Mr. Whittome
Mr. Wiesner
Mr. Beza
Mr. Brown

THE WORLD BANK
Washington, D. C. 20433
U.S.A.

A.W. CLAUSEN
President

cc: Mr. Guitian

November 8, 1985

RECEIVED
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EXCHANGE & TRADE RELATIONS

Dear Jacques:

Just a note to express my appreciation and thanks for joining our breakfast gathering of senior bank managers last Wednesday. Your message on the respective roles of our two institutions in the aftermath of Seoul and on Fund/Bank collaboration was both timely and thought-provoking. I have received many favorable comments on your presentation which is quite an accomplishment given the collective disposition of Bank managers at that time in the morning. Seriously, Jacques, yours was an extremely important message that proved to be enlightening for us all.

I appreciate your taking the time to share your thoughts with us.

Warm regards.

Sincerely,

Tom

Mr. Jacques de Larosiere
Manager Director
The International Monetary Fund
Washington, D. C.

Mr. Finch

# Office Memorandum

MEMORANDUM FOR FILES

November 7, 1985

SUBJECT: Meeting with Bankers on U.S. Debt Initiative

At the request of Ms. Susan Segal (Senior Vice President, Manufacturers Hanover Trust), meetings were held in the Fund and the World Bank on Monday, November 4 with representatives of the G-14 banks to discuss bank attitudes toward Secretary Baker's initiative. In addition to Ms. Segal, representatives of Citibank, Dresdner Bank, Lloyds Bank, and the Bank of Tokyo were present. Mr. Finch chaired the meetings in the Fund and the Deputy Managing Director hosted a lunch for the participants, which was attended by Messrs. Wiesner and Beza, and by Messrs. Stern, Knox, and Bock of the World Bank. Mr. Bock joined the Fund meetings, and Mr. Watson joined those in the Bank.

The banks were supportive of the U.S. proposals, although the non-U.S. banks noted a strong concern that early steps should be taken to "internationalize" the initiative. The banks wanted to discuss the roles of the different parties concerned by the initiative, with a view to drafting a "memorandum of understanding" detailing the roles of these parties (e.g., creditor governments, the Paris Club, export credit agencies, bank supervisors, multilateral development banks, the Fund, and commercial banks).

As large banks, they were also seeking an official initiative to secure a general public commitment to the Baker plan from the entire international banking community, especially banks with small exposures to developing countries, and to legitimize the role of the expanded G-14 as a spokesman for the international banking community. In particular, the banks desired that the Managing Director and the President of the World Bank telex to the international banking community a request for their public commitment in general terms to the Baker plan. Conversations at the U.S. Treasury and the Federal Reserve indicated to these banks that such a concrete initiative would not be launched by them. Fund and Bank participants in the meetings indicated that a first step would be for national governments to indicate support of the initiative to their own banks.

Several other issues were raised by the bankers during the course of the day.

1. Strong support was expressed for the case-by-case approach to addressing countries' need for external financing. The banks thought that the countries receiving net new bank lending and the amount of such lending would vary from year to year. However, two year lending packages for 1986-87 were a possible approach because of the difficulties and delays associated with assembling each financing package.

2. Some banks thought that the list of countries might be too short and that more than U.S. $20 billion may be required. They also emphasized that countries should be able to graduate from the list, while other countries might join it. In particular, the European banks had questions whether the amount would be sufficient when possible

financing needs of Brazil and the Philippines came to be assessed. The banks noted that the financing requests of these and other countries (particularly Venezuela) might be scaled up in light of the Baker initiative.

3. In their view, disbursements under bank lending packages should--in principle--be linked to both purchases under a Fund arrangement and a World Bank structural adjustment loan or sector loan. They pressed extremely forcefully for financial protection by the World Bank, in the form of guarantees, cross default clauses or subparticipation in World Bank loans. The Bank made clear that they believed that such arrangements could be counterproductive, although some selective use of guarantees was not ruled out.

4. They were worried about the feasibility of obtaining commitments from banks with small exposures. For major debtors, such as Argentina and Mexico, they felt that there was little choice but to include all creditor banks in the initial approach for new money. However, it might be necessary at some stage to introduce new techniques to facilitate a contribution by banks with small exposures. Manufacturers Hanover and Dresdner Bank were studying such devices as exit bonds (on fairly stiff terms) to allow such banks to contribute to genuine debt relief where they were not interested in future lending. For some debtor countries that were well advanced in adjustment--or had very modest net financing needs--the banks thought that cofinancings with limited groups of friendly banks should be studied carefully as an option.

5. The banks also expressed dissatisfaction with the degree of payments relief provided by the Paris Club to certain countries (e.g., Ecuador). One concern was that under any official MYRAs, interest payments might not be rescheduled, while banks might now be expected to provide new money to such countries.

The Deputy Managing Director and Mr. Stern were invited to attend a meeting of the expanded G-14 in New York on Friday to carry forward this discussion with the broader group of banks.

C.M. Watson
Chief
International Capital Markets Division
Exchange and Trade Relations Department

cc: Managing Director
Deputy Managing Director
Mr. Finch
Mr. Wiesner
Mr. Beza
Mr. Brown

cc: Mr. Bracket
Ms. Dillon
Mr. Watson



**INTERNATIONAL MONETARY FUND**

November 7, 1985

This is the revised and final version of the note discussed at today's Heads of Departments meeting.

Robert M.G. Brown

**Office of the Managing Director**

INTERNATIONAL MONETARY FUND
WASHINGTON, D.C. 20431

MANAGING DIRECTOR

CABLE ADDRESS
INTERFUND

November 7, 1985

To: Heads of Departments, Bureaus and Offices

From: The Managing Director Larosière

Subject: Implementation of the Debt Strategy

At the Annual Meetings in Seoul, U.S. Secretary of the Treasury Baker outlined proposals for strengthening the international debt strategy which has been followed during the past three years. Three essential elements were identified:

(1) "the adoption by principal debtor countries of comprehensive macroeconomic and structural policies, supported by the international financial institutions, to promote growth and balance of payments adjustment, and to reduce inflation.

(2) a continued central role for the IMF, in conjunction with increased and more effective structural adjustment lending by the multilateral development banks (MDBs), both in support of the adoption by principal debtors of market-oriented policies for growth.

(3) increased lending by the private banks in support of comprehensive economic adjustment programs."

Secretary Baker outlined a rough quantitative framework for such lending over the medium-term. Focusing on a group of heavily indebted, middle-income developing countries (see Annex), he called on the World Bank and the Inter-American Development Bank to increase their disbursements to these countries by roughly 50 per cent from their current annual level of nearly $6 billion and on the banks to pledge new lending in the range of $20 billion for the next three years. In addition--and this is an important part of the initiative-- Secretary Baker stated that "it would be necessary that countries now receiving adequate financing from banks on a voluntary basis continue to do so, provided they maintain sound policies."

At this time, discussions are taking place on some important elements of this initiative, including in particular the role of commercial banks and also the role of the multilateral development banks. However this broad framework evolves, it is clear that implementation of the debt strategy will continue to be carried out on a case-by-case basis and that the Fund will continue to play its central role. During the coming weeks a number of Fund staff missions will be conducting Article IV discussions, program reviews, and new program negotiations. No doubt governments will be thinking about and in some cases reacting to the recent debt initiatives as they plan their economic policies and external borrowing arrangements for 1986 and beyond. As work proceeds, there may be uncertainty about the magnitude of the external financing prospects for individual countries.

In these circumstances I would like to emphasize the following points which cover all developing countries:

(1) Missions preparing programs, carrying out enhanced surveillance, or conducting Article IV reviews should place particular emphasis on assisting governments in making projections of financing requirements associated with policy plans for 1986, 1987, and where possible 1988. I should add that the 2½-3 per cent increase in bank exposure implied by Secretary Baker's indicative numbers should not be viewed either as a limit or an entitlement by any single country identified in the illustrative group. Indeed, the appropriate overall amount of financing and its sources for any country will need to continue to be judged, inter alia, in the light of the country's economic policies and prospects as well as its external debt position.

(2) Missions should maintain close collaboration with their counterparts in the World Bank, Inter-American Development Bank (and other regional development banks as appropriate) in order to keep abreast of their analysis, policy advice and financing plans for individual countries as these evolve in the light of the responses to the Baker initiative. More specifically, concerning the list of countries currently included in the Baker initiative, missions should get as precise an idea as possible from the World Bank and the IDB of the <u>additional</u> financing effort contemplated by those institutions as their potential contribution toward meeting the order of magnitude suggested by the American initiative.

(3) With respect to commercial bank financing, Fund staff should continue to leave it to the countries to initiate discussions about commercial bank financing prospects. If the country wishes our assistance, however, we should be prepared to help and at a later stage continue to play our customary catalytic role.

(4) In the context of WEO, the Research Department with support from the area departments and ETR will be responsible for monitoring overall financial flows to the developing countries, including the progress towards achievement of the $20 billion and $9 billion indicative amounts for the list of countries which the United States has mentioned for illustrative purposes.

ANNEX

Secretary Baker's Illustrative List
of Heavily Indebted, Middle-Income Countries1/

Argentina

Bolivia

Brazil

Chile

Colombia

Ecuador

Ivory Coast

Mexico

Morocco

Nigeria

Peru

Philippines

Uruguay

Venezuela

Yugoslavia

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1/ It is also understood that other countries which have not yet regained normal access to commercial lending could be treated in a similar framework.

cc: Mr. Bracher
Ms. Dillon
Mr. Watson



**INTERNATIONAL MONETARY FUND**

November 7, 1985

This is the revised and final version of the note discussed at today's Heads of Departments meeting.

Robert M.G. Brown

**Office of the Managing Director**

INTERNATIONAL MONETARY FUND
WASHINGTON, D. C. 20431

MANAGING DIRECTOR

CABLE ADDRESS
INTERFUND

November 7, 1985

To: Heads of Departments, Bureaus and Offices

From: The Managing Director Larosière

Subject: Implementation of the Debt Strategy

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(2) a continued central role for the IMF, in conjunction with increased and more effective structural adjustment lending by the multilateral development banks (MDBs), both in support of the adoption by principal debtors of market-oriented policies for growth.

(3) increased lending by the private banks in support of comprehensive economic adjustment programs."

Secretary Baker outlined a rough quantitative framework for such lending over the medium-term. Focusing on a group of heavily indebted, middle-income developing countries (see Annex), he called on the World Bank and the Inter-American Development Bank to increase their disbursements to these countries by roughly 50 per cent from their current annual level of nearly $6 billion and on the banks to pledge new lending in the range of $20 billion for the next three years. In addition--and this is an important part of the initiative-- Secretary Baker stated that "it would be necessary that countries now receiving adequate financing from banks on a voluntary basis continue to do so, provided they maintain sound policies."

At this time, discussions are taking place on some important elements of this initiative, including in particular the role of commercial banks and also the role of the multilateral development banks. However this broad framework evolves, it is clear that implementation of the debt strategy will continue to be carried out on a case-by-case basis and that the Fund will continue to play its central role. During the coming weeks a number of Fund staff missions will be conducting Article IV discussions, program reviews, and new program negotiations. No doubt governments will be thinking about and in some cases reacting to the recent debt initiatives as they plan their economic policies and external borrowing arrangements for 1986 and beyond. As work proceeds, there may be uncertainty about the magnitude of the external financing prospects for individual countries.

In these circumstances I would like to emphasize the following points which cover all developing countries:

(1) Missions preparing programs, carrying out enhanced surveillance, or conducting Article IV reviews should place particular emphasis on assisting governments in making projections of financing requirements associated with policy plans for 1986, 1987, and where possible 1988. I should add that the 2½-3 per cent increase in bank exposure implied by Secretary Baker's indicative numbers should not be viewed either as a limit or an entitlement by any single country identified in the illustrative group. Indeed, the appropriate overall amount of financing and its sources for any country will need to continue to be judged, inter alia, in the light of the country's economic policies and prospects as well as its external debt position.

(2) Missions should maintain close collaboration with their counterparts in the World Bank, Inter-American Development Bank (and other regional development banks as appropriate) in order to keep abreast of their analysis, policy advice and financing plans for individual countries as these evolve in the light of the responses to the Baker initiative. More specifically, concerning the list of countries currently included in the Baker initiative, missions should get as precise an idea as possible from the World Bank and the IDB of the <u>additional</u> financing effort contemplated by those institutions as their potential contribution toward meeting the order of magnitude suggested by the American initiative.

(3) With respect to commercial bank financing, Fund staff should continue to leave it to the countries to initiate discussions about commercial bank financing prospects. If the country wishes our assistance, however, we should be prepared to help and at a later stage continue to play our customary catalytic role.

(4) In the context of WEO, the Research Department with support from the area departments and ETR will be responsible for monitoring overall financial flows to the developing countries, including the progress towards achievement of the $20 billion and $9 billion indicative amounts for the list of countries which the United States has mentioned for illustrative purposes.

ANNEX

Secretary Baker's Illustrative List
of Heavily Indebted, Middle-Income Countries1/

Argentina

Bolivia

Brazil

Chile

Colombia

Ecuador

Ivory Coast

Mexico

Morocco

Nigeria

Peru

Philippines

Uruguay

Venezuela

Yugoslavia

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1/ It is also understood that other countries which have not yet regained normal access to commercial lending could be treated in a similar framework.

# Office Memorandum

To: The Managing Director November 8, 1985

From: G. Russell Kincaid GRK

Subject: Technical Note on New Money Packages

In the absence of Mr. Watson, who is away on business in New York with the Deputy Managing Director, I have revised the above titled note along the lines suggested by you in your comments on Mr. Watson's memorandum of November 7.

Attachment

cc: The Deputy Managing Director
Mr. Finch
Mr. Brown
Mr. Watson (o/r)

mm5rk2 (CAC)

# Technical Note on New Money Packages

## 1. Introduction

Difficult issues have arisen concerning the willingness of banks with smaller exposures to provide new financing to developing countries pursuing appropriate economic policies. In the case of several key debtor countries (including Argentina and Mexico) banks with large exposures are unlikely to accept an approach under which they are obliged to participate in new financing, while banks with small exposures fail to participate yet receive their interest payments in full. In particular, some European banks have indicated that the nonparticipation of U.S. regional banks would be unacceptable.

It thus appears important to study whether there are viable means of allowing banks with small exposures to participate in the burden-sharing by alternative modalities to the new money approach. In this regard, a key constraint is that any additional flexibility in the new money process should not involve increased risks of a generalized spread of interest capitalization.

The question whether claims can be provided in a form more acceptable to banks with small exposures is one of central importance. If the answer to this question is negative, then there is a straight choice between moving to a limited group of banks for a new money package, or accepting that the new money may only be available after protracted delays, as the process of erosion of participation by small creditors gradually takes place and is accepted.

## 2. Review of possible options

The options that have already been included in some rescheduling or new money agreements, such as onlending and trade facilities, generally may not meet the preferences of banks with very small exposures, whose interest in longer term relationships in the debtor country may be nonexistent. Several other possibilities could be envisaged to offer banks with small exposures instruments or types of claims that they would more readily accept. These possible modalities should be examined carefully, with a view to determining to what degree they would genuinely facilitate the participation of banks with small exposures.

The response of banks to an increased flexibility in the modalities of restructurings and new money packages will depend on the reasons for their dissent. The principal obstacle to participation in new money packages by small banks appears to be a managerial one. There is a desire not to present proposals for new loans to questionable borrowers, because of the possible adverse effects of association with such lending and a belief that nonparticipation will not materially damage the economic position of the bank.

Two basic types of options for obtaining greater participation of banks with small exposures appear promising. One, where banks have an objection in principle to advancing further debt finance, the provision of an equity option may give some reassurance. Banks could be allowed by the debtor country to acquire equity claims on selected entities in the debtor country, in lieu of a portion of the new money requirement or existing bank claims. Such an approach would involve banks in longer term investments in the debtor country, possibly encourage the privatization of parastatal bodies, and reduce the indebtedness of the country. However, the scope for equity participation varies so greatly among debtor countries that country-specific equity funds would appear to be the preferable approach. One difficulty with the equity approach is identifying profitable entities for investment. In this regard, the IFC could play an invaluable role in managing the transformation of debt into equity by these country specific trusts.

A second option that, in the case of many smaller banks, might facilitate their participation would be a modality whereby part of their interest receipts would in practice be recycled to the debtor country without a full review of a new loan by the banks' credit committees and boards. The question is whether techniques for achieving this particular objective can be met without resulting in a more general shift toward interest capitalization or seriously affecting the valuation of claims by some key banks which are not in a position to make provisions on the scale implied.

One key to minimizing the negative impact of recycling some interest payments would be to contrive modalities whereby interest was paid in full at source, but then part of it was recycled to the debtor country by an intermediary body on behalf of the banks with small exposures. This would amount to an accounting illusion, whereby the country was seen to pay interest in full, but the flow was interrupted to avoid the need for formal commitment of new money by the banks concerned. Under such an arrangement, these banks could hold claims on a trust fund specific to the debtor country but located outside the debtor country. In the simplest form, these would be book claims, on which interest payments would be made net of any recycling. The holders' claims on the fund would rise in proportion to the amounts recycled.

In order to limit the scale of such arrangements, and to preserve the appearance of a relatively integrated restructuring package, these arrangements could be presented as one among several options in a restructuring package. Most of these options would probably have ceilings on utilization, applied either by creditor or in aggregate. In the case of a recycling fund, it would appear appropriate to apply the ceilings on a creditor basis, so that banks with smaller exposures could in practice convert all of their claims, but the bulk of the funds would be lent directly to the country in the form of a traditional new money package.

One clear danger in creating such trust funds is that they could appear too appealing. For example, if they were administered by a multilateral institution, they might be seen as implicitly guaranteed. If so, their role and scale could be difficult to limit. In the view of some banks there should therefore be a clear and significant cost to participating through these trusts, rather than direct lending to the country.

Thus, arrangements could be devised under which the claims on the fund were transferable, and would thus constitute "exit bonds". Because of the uncertainty about the stream of future interest payments, and a desire by some banks to liquidate their positions, such bonds would probably fall to a considerable discount initially. This would in practice penalize banks that were holding such claims. Moreover, these banks would be penalized by a loss of control over the new money process. Of course, such arrangements contain countervailing dangers. In particular, widespread issuance of "exit bonds" at a deep discount could lead to a decline in confidence as regards the creditworthiness of a country and pose problems as regards the valuation of other banks' claims on the country.

3. <u>Conclusion</u>

It seems important to decide in the near future whether the problem of small bank participation is likely to become so serious that innovation in the restructuring/new money process is necessary to deal with it. Because of the dangers indicated above, such a decision would not be taken lightly. However, the costs of protracted delays in assembling packages are considerable also, and such delays could increase now that banks are aware that a further extended period of new money provision in in prospect.

In light of these considerations, it would appear worth considering inviting a group of bankers and lawyers to examine arrangements that could operate along these lines. Such a technical study could be valuable, but it would be important to place it in a broader perspective. Three considerations would remain particularly important:

-- While more flexible technical modalities may assist in this process, a key determinant of success will be the degree to which authorities in industrial countries actually support efforts to muster new financing. In some cases, banks might seek to avoid adopting such an option and, in this regard, the support of monetary authorities would be most important.

-- Modalities designed to encourage participation by smaller banks could spread by contagion, resulting (for example) in a generalized adoption of interest capitalization.

-- The modalities adopted to facilitate participation in burden-sharing by smaller banks should not result in a shift away from a country-by-country approach to assembling financial packages.

RECEIVED
INTERNATIONAL
MONETARY FUND

1985 NOV -8 PM 5:25

OFFICE OF
THE MANAGING DIRECTOR

# Office Memorandum

Mr Rose
Mr Finch

November 8, 1985

TO: The Managing Director
The Deputy Managing Director

FROM: Brian Rose BR

SUBJECT: Switzerland and the Baker Initiative

Mr. Szapary telephoned from Zurich this morning to say that Mr. Languetin made four points to him in regard to the Baker initiative:

(1) According to Mr. Languetin's calculations, the sums of money mentioned--$20 billion more from the commercial banks and $9 billion more from the IBRD and IDB--fell far short of what was needed. If all this money went to the 15 countries Mr. Baker had in mind, what was to happen to the other LDCs?

(2) Mr. Languetin also thought that it was vital to define what was meant by fresh money. Suppose that commercial bank A agreed to capitalize interest but did not extend new credits, and that commercial bank B insisted on receiving interest due but then extended an equal amount of fresh credit: Mr. Languetin thought that commercial bank B was likely to claim that it was providing fresh money although in fact the end result was exactly the same for both bank A and bank B.

(3) The Swiss authorities welcome Mr. Baker's initiative as a recognition of the problem, but Mr. Languetin emphasized that the Swiss authorities could give no guarantees, and that their general view was that "the banks know what they are doing."

(4) Mr. Languetin pointed out that about one quarter of the borrowing requirements of the IBRD were raised in Swiss francs. If the new push led to more structural adjustment lending with a dilution of conditionality, the IBRD's creditworthiness on the Swiss market could be adversely affected.

No doubt Mr. Szapary will be enlarging on these points in his back-to-office report, but I have written this note because he will not be returning to Washington until November 18.

cc: Mr. Whittome (o/r)
Mr. Szapary (o/r)
Mr. Brown

**INTERNATIONAL MONETARY FUND**

November 8, 1985

Mr. Finch
Mr. Beveridge

Attached for your information are the Managing Director's comments on two notes recently prepared by Mr. Watson. I am preparing a revised text along the lines suggested by the Managing Director.

Attachment

G. Russell Kincaid

# *Office Memorandum*

Very good notes. We should indeed follow them up [illegible] I would like you [illegible] (cf. Chile) [illegible] 7.85

1985 NOV -7 PM 6: 37

**To:** The Managing Director
The Deputy Managing Director

November 7, 1985

**From:** C. M. Watson

**Subject:** <u>New Money Packages</u>

You asked us to explore somewhat further modalities to facilitate the participation of small banks in new money packages. The attached memorandum draws together material on this subject from earlier submissions, and develops this to some extent. Four main points emerge from this discussion.

First, it would appear desirable to initiate study of an option to be included in rescheduling/new money arrangements that would offer banks with small exposures a more acceptable route to contribute to the provision of payments relief for the debtor country. Existing options such as on-lending, trade facilities, or the direct equity stake available in the Chile arrangements, do not appear likely to have sufficient appeal for this purpose.

Second, the main problem in the case of many banks with small exposures appears to be a managerial one. They are prepared to contribute to some degree to payments relief, but they wish to dissociate themselves from active new lending decisions. Thus, the characteristic of an additional option would be based on their acceptance that they would receive less than full value for their existing rights to either interest or principal (or both), in exchange for the recognition that they would not be called upon for future new lending. The challenge would be to try to design an instrument which achieves this, but runs the minimum risks of a shift toward unilateral interest rescheduling by the debtor country.

Third, in light of these considerations, one priority for study is some form of intermediary fund, specific to the debtor country but located outside its borders, to which the country would pay in full interest on a small proportion of its debt liabilities. Banks exercising the option would receive claims on this fund, possibly with a right to dispose of these claims immediately or over time. The fund would recycle to the member country some portion of the interest receipts, probably reflecting a negotiated scale of new money provision in any particular future year.

Fourth, to limit the spread of such an option, two considerations would be important. Entitlement should be limited--for example to a maximum dollar amount of any creditor's claims (although that would be set at a level allowing banks with small exposures to exchange all of their claims). Moreover, the attributes of the fund should not be too attractive, so that there is not a widespread incentive for banks with medium-sized exposures to press for a right to use this route. In this regard, there might be dangers in arranging for the fund to be managed by a multilateral institution, which could imply some implicit guarantee of the value of the claims. The notion that claims on the fund would be tradeable and would trade at a significant discount may have merit in signaling that it is not a privileged vehicle.

Attachment

cc: Mr. Finch
Mr. Brown

# Technical Note on New Money Packages

## 1. Introduction

Difficult issues have arisen concerning the willingness of banks with smaller exposures to provide new financing to developing countries pursuing appropriate economic policies. In the case of several key debtor countries (including Argentina and Mexico) banks with large exposures are unlikely to accept an approach under which they are obliged to participate in new financing, while banks with small exposures fail to participate yet receive their interest payments in full. In particular, some European banks have indicated that the nonparticipation of U.S. regional banks would be unacceptable.

It thus appears important to study whether there are viable means of allowing banks with small exposures to participate in the burden-sharing by alternative modalities to the new money approach. In this regard, a key constraint is that any additional flexibility in the new money process should not involve increased risks of a generalized spread of interest capitalization.

The question whether claims can be provided in a form more acceptable to banks with small exposures is one of central importance. If the answer to this question is negative, then there is a straight choice between moving to a limited group of banks for a new money package, or accepting that the new money may only be available after protracted delays, as the process of erosion of participation by small creditors gradually takes place and is accepted.

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The response of banks to an increased flexibility in the modalities of restructurings and new money packages will depend on the reasons for their dissent. The principal obstacle to participation in new money packages by small banks appears to be a managerial one. There is a desire not to present proposals for new loans to questionable borrowers, because of the possible adverse effects of association with such lending and a belief that nonparticipation will not materially damage the economic position of the bank.

Where the banks have an objection in principle to advancing further debt finance, the provision of an equity option may give some reassurance. But in the case of many smaller banks, the course that would most facilitate their participation would be a modality whereby part of their interest receipts would in practice be recycled to the debtor country without a full review of a new loan by the banks' credit committees and boards. The question is whether techniques for achieving this particular objective can be met without resulting in a more general shift toward interest capitalization or seriously affecting the valuation of claims by some key banks which are not in a position to make provisions on the scale implied.

One key to minimizing the negative impact of recycling some interest payments would be to contrive modalities whereby interest was paid in full at source, but then part of it was recycled to the debtor country by an intermediary body on behalf of the banks with small exposures. This would amount to an accounting illusion, whereby the country was seen to pay interest in full, but the flow was interrupted to avoid the need for formal commitment of new money by the banks concerned. Under such an arrangement, these banks could hold claims on a trust fund specific to the debtor country but located outside the debtor country. In the simplest form, these would be book claims, on which interest payments would be made net of any recycling. The holders' claims on the fund would rise in proportion to the amounts recycled.

In order to limit the scale of such arrangements, and to preserve the appearance of a relatively integrated restructuring package, these arrangements could be presented as one among several options in a restructuring package. Most of these options would probably have ceilings on utilization, applied either by creditor or in aggregate. In the case of a recycling fund, it would appear appropriate to apply the ceilings on a creditor basis, so that banks with smaller exposures could in practice convert all of their claims, but the bulk of the funds would be lent directly to the country in the form of a traditional new money package.

One clear danger in creating such trust funds is that they could appear too appealing. For example, if they were administered by a multilateral institution, they might be seen as implicitly guaranteed. If so, their role and scale could be difficult to limit. In the view of some banks there should therefore be a clear and significant cost to participating through these trusts, rather than direct lending to the country.

Thus, arrangements could be devised under which the claims on the fund were transferable, and would thus constitute "exit bonds". Because of the uncertainty about the stream of future interest payments, and a desire by some banks to liquidate their positions, such bonds would probably fall to a considerable discount initially. This would in practice penalize banks that were holding such claims. Moreover, these banks would be penalized by a loss of control over the new money process. Of course, such arrangements contain countervailing dangers. In particular, widespread issuance of "exit bonds" at a deep discount could lead to a decline in confidence as regards the creditworthiness of a country and pose problems as regards the valuation of other banks' claims on the country.

3. Conclusion

It seems important to decide in the near future whether the problem of small bank participation is likely to become so serious that innovation in the restructuring/new money process is necessary to deal with it. Because of the dangers indicated above, such a decision would not be taken lightly. However, the costs of protracted delays in assembling packages are considerable also, and such delays could increase now that banks are aware that a further extended period of new money provision in in prospect.

In light of these considerations, it would appear worth considering inviting a group of bankers and lawyers to examine arrangements that could operate along these lines. Such a technical study could be valuable, but it would be important to place it in a broader perspective. Three considerations would remain particularly important:

-- While more flexible technical modalities may assist in this process, a key determinant of success will be the degree to which authorities in industrial countries actually support efforts to muster new financing. In some cases, banks might seek to avoid adopting such an option, and in this regard the support of monetary authorities would be **most** important.

-- Modalities designed to encourage participation by smaller banks could spread by contagion, resulting (for example) in a generalized adoption of interest capitalization.

-- The modalities adopted to facilitate participation in burden-sharing by smaller banks should not result in a shift away from a country-by-country approach to assembling financial packages.

# Office Memorandum

Interesting
JP NOV 7.85

MEMORANDUM FOR FILES

November 7, 1985



SUBJECT: Meeting with Bankers on U.S. Debt Initiative

At the request of Ms. Susan Segal (Senior Vice President, Manufacturers Hanover Trust), meetings were held in the Fund and the World Bank on Monday, November 4 with representatives of the G-14 banks to discuss bank attitudes toward Secretary Baker's initiative. In addition to Ms. Segal, representatives of Citibank, Dresdner Bank, Lloyds Bank, and the Bank of Tokyo were present. Mr. Finch chaired the meetings in the Fund and the Deputy Managing Director hosted a lunch for the participants, which was attended by Messrs. Wiesner and Beza, and by Messrs. Stern, Knox, and Bock of the World Bank. Mr. Bock joined the Fund meetings, and Mr. Watson joined those in the Bank.

The banks were supportive of the U.S. proposals, although the non-U.S. banks noted a strong concern that early steps should be taken to "internationalize" the initiative. The banks wanted to discuss the roles of the different parties concerned by the initiative, with a view to drafting a "memorandum of understanding" detailing the roles of these parties (e.g., creditor governments, the Paris Club, export credit agencies, bank supervisors, multilateral development banks, the Fund, and commercial banks).

As large banks, they were also seeking an official initiative to secure a general public commitment to the Baker plan from the entire international banking community, especially banks with small exposures to developing countries, and to legitimize the role of the expanded G-14 as a spokesman for the international banking community. In particular, the banks desired that the Managing Director and the President of the World Bank telex to the international banking community a request for their public commitment in general terms to the Baker plan. Conversations at the U.S. Treasury and the Federal Reserve indicated to these banks that such a concrete initiative would not be launched by them. Fund and Bank participants in the meetings indicated that a first step would be for national governments to indicate support of the initiative to their own banks.

Several other issues were raised by the bankers during the course of the day.

1. Strong support was expressed for the case-by-case approach to addressing countries' need for external financing. The banks thought that the countries receiving net new bank lending and the amount of such lending would vary from year to year. However, two year lending packages for 1986-87 were a possible approach because of the difficulties and delays associated with assembling each financing package.

2. Some banks thought that the list of countries might be too short and that more than U.S. $20 billion may be required. They also emphasized that countries should be able to graduate from the list, while other countries might join it. In particular, the European banks had questions whether the amount would be sufficient when possible

financing needs of Brazil and the Philippines came to be assessed. The banks noted that the financing requests of these and other countries (particularly Venezuela) might be scaled up in light of the Baker initiative.

3. In their view, disbursements under bank lending packages should--in principle--be linked to both purchases under a Fund arrangement and a World Bank structural adjustment loan or sector loan. They pressed extremely forcefully for financial protection by the World Bank, in the form of guarantees, cross default clauses or subparticipation in World Bank loans. The Bank made clear that they believed that such arrangements could be counterproductive, although some selective use of guarantees was not ruled out.

We should follow this up

4. They were worried about the feasibility of obtaining commitments from banks with small exposures. For major debtors, such as Argentina and Mexico, they felt that there was little choice but to include all creditor banks in the initial approach for new money. However, it might be necessary at some stage to introduce new techniques to facilitate a contribution by banks with small exposures. Manufacturers Hanover and Dresdner Bank were studying such devices as exit bonds (on fairly stiff terms) to allow such banks to contribute to genuine debt relief where they were not interested in future lending. For some debtor countries that were well advanced in adjustment--or had very modest net financing needs--the banks thought that cofinancings with limited groups of friendly banks should be studied carefully as an option.

5. The banks also expressed dissatisfaction with the degree of payments relief provided by the Paris Club to certain countries (e.g., Ecuador). One concern was that under any official MYRAs, interest payments might not be rescheduled, while banks might now be expected to provide new money to such countries.

The Deputy Managing Director and Mr. Stern were invited to attend a meeting of the expanded G-14 in New York on Friday to carry forward this discussion with the broader group of banks.

C.M. Watson
Chief
International Capital Markets Division
Exchange and Trade Relations Department

cc: Managing Director
Deputy Managing Director
Mr. Finch
Mr. Wiesner
Mr. Beza
Mr. Brown

Mr. Finch

cc: Mr. Beveniage
Mr. Guitián
Mr. Kerouard

# *Office Memorandum*

RECEIVED
NOV 18 1985
EXCHANGE & TRADE RELATIONS

TO: Managing Director
Deputy Managing Director

November 15, 1985

FROM: A.D. Crockett ADC.

SUBJECT: The Baker Initiative: Plans for Monitoring Bank Lending

I thought it might be useful to apprise you of our plans for monitoring the external financing situation of the 15 countries covered by the U.S. debt initiative. These plans are tentative, and likely to evolve as we develop understandings with the area departments, and as the modalities attaching to the Baker initiative itself are clarified. We would, of course, welcome any suggestions you might have for increasing the usefulness of the contemplated reports.

The central part of the project will be the monitoring of lending by commercial banks and multilateral development banks (MDBs) to the 15 countries covered by the U.S. debt initiative. One facet of this work will be retrospective, i.e., focused on what has been the actual level of lending. Here, the emphasis will be on the quarterly data on bank lending generated by the Bureau of Statistics and on quarterly MDB commitments and disbursements data to be provided by the IBRD, IDB, and other development banks The other major facet of the work will be more forward-looking, i.e., focused on the expected evolution --both in absolute terms and in relation to what it might have been in the absence of the Baker initiative--of financing in each of the 15 countries over the period to end-1988. This part of the project will rely heavily on information provided by the area departments. At this juncture, we are thinking of anchoring this activity in the regular WEO exercises, which provide the framework necessary for full-scale analyses, supplementing those estimates with intervening area department updating of the key data whenever they provide Management with revisions to their views on countries' financing prospects.

At this stage, we anticipate presenting reports containing a mixture of tabular and chart material covering both aggregate and individual country developments. Aggregate statistics would also be provided of developments among those market borrowers not included in the U.S. list. The reports would contain a brief interpretative text.

Insofar as the frequency of reports is concerned, we expect to provide you with a first progress report before the middle of December. That report will include tables and charts showing the available historical data and estimates of net lending that would have occurred in the absence of the Baker initiative. The next report would be in late January or early February. At that time, we would have the 1985 third quarter IBS data, the 1985 fourth quarter IBRD and IDB data, and area department WEO estimates through 1988. We would expect to provide reports at least quarterly thereafter, with intervening reports (perhaps one more per quarter) being provided whenever significant changes in circumstances occurred.

Many issues remain to be addressed, of course. There are sure to be difficulties with the basic data and in agreeing upon the baseline forecast for net lending. A rather different issue concerns our eventual need for information on bank lending broken down by country of origin. Mr. Fujino's intervention in the Board on Wednesday (where he contrasted the rapid rise in bank lending by Japanese banks with the stagnant overall trend) may be a precursor of debates to come on this score. If so, there is likely to be a need for information on lending by nationality. However this information is regarded as extremely confidential by the Bureau of Statistics. Should we initiate the steps that would be required to gain access to such information?

cc: Mr. Dannemann
Mr. Finch
Mr. Hood (on return)
Mr. Ouattara
Mr. Shaalan
Mr. Tun Thin
Mr. Whittome
Mr. Wiesner
Mr. Brown

INTERNATIONAL MONETARY FUND

November 5, 1985

The Deputy Managing Director:

You may be interested by the attached note from Mr. Watson concerning the Federal Reserve's approach to other countries on the impact of banking supervision on lending to developing countries. This would appear to be supportive of the Baker initiative. Our views were sought in confidence and it would seem right to treat this information as somewhat sensitive.

Attachment

C. DAVID FINCH

# *Office Memorandum*

To: Mr. Finch November 5, 1985

From: C.M. Watson

Subject: Federal Reserve Initiative on Banking Supervision and Lending to Developing Countries

I was telephoned today by Allen Frankel of the Federal Reserve Board who wished to discuss the impact of provisioning policy in industrial countries on the flow of lending to developing countries. During the course of the conversation it emerged that he was preparing a briefing from which Chairman Volcker will speak to the G-10 Governors at this weekend's Basle meeting.

We had a lengthy discussion of the issues involved, some of which were relatively new to him. He is obtaining a copy of our background paper on capital markets which contains an evaluation of these issues. In talking to him I made three particular points:

1. Our concern about the impact of the mandatory provisioning systems in some countries (including Canada and Japan), which result in provisions against all increases in exposure to a group of countries that have rescheduled their debt in recent years, irrespective of economic performance.

2. A number of the concerns raised with us by U.S. money center and regional banks about the impact of the U.S. country classification system. I flagged in particular the treatment of Argentina (which many banks read as requiring write-offs during the course of a new money package) and the more general issue of upgrading countries where an effort was being made to return them to more normal market access.

3. In discussing the high degree of tax deductibility available to banks in countries such as Germany, which encouraged voluntary write-offs, I pointed out that the practical effect of this can be to cause banks with smaller exposures to treat these loans as irrecoverable and unsuitable for support through new lending.

After we had discussed provisioning, I mentioned that we also saw some difficulties in the Cooke Committee view that systematically higher capital requirements should be placed against exposure to all countries outside the Fund's "industrial country" group, irrespective of economic performance. He indicated in confidence that the United States is also pressing against this tendency, but without much success.

FOR AGENDA

SM/85/267
Supplement 1

CONTAINS CONFIDENTIAL
INFORMATION

November 1, 1985

To: Members of the Executive Board

From: The Secretary

Subject: International Capital Markets - Developments and Prospects, 1985 - U.S. Treasury Initiative on Debt

The attached supplement to the paper on developments and prospects in international capital markets presents the U.S. Treasury proposals.

This subject has been scheduled for discussion by the Executive Board on Wednesday, November 6, 1985.

Mr. Watson (ext. 7350) or Mr. Kincaid (ext. 7356) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Att: (1)

Other Distribution:
Department Heads

CONTAINS CONFIDENTIAL INFORMATION

INTERNATIONAL MONETARY FUND

# International Capital Markets: Developments and Prospects, 1985-- Supplementary Material: U.S. Treasury Initiative on Debt

(In consultation with the Western Hemisphere Department)

Approved by C. David Finch

November 1, 1985

## I. Introduction

In his address to the 1985 Annual Meetings of the Fund and World Bank, the Honorable James A. Baker III, Secretary of the U.S. Treasury, proposed a "Program for Sustained Growth" to strengthen the present international debt strategy. The Treasury Secretary noted the recent difficulties experienced by debtor countries in implementing successful economic policies and in generating the financing needed to support essential economic reforms. In the light of these problems, Mr. Baker proposed a three-point plan that would build upon the flexible, case-by-case debt strategy developed in the past three years. This paper summarizes aspects of the plan that are particularly relevant to capital markets.

The first element in the U.S. proposal is the adoption by principal debtor countries of comprehensive macroeconomic and structural policies to promote growth and balance of payments adjustment, and to reduce inflation. The second element is a continued central role for the IMF, in conjunction with increased and more effective lending by multilateral development banks. The third is increased lending by the private banks in support of comprehensive adjustment programs.

The proposal is aimed primarily at stimulating the process of growth and adjustment in heavily indebted developing countries and encouraging new financing flows from both official and private sources to reinforce this process. In addition to the continued application of macroeconomic policies to deal with economic and financial imbalances, the U.S. proposal envisages increased emphasis on medium- and long-term supply side policies to promote growth, savings and investment. The plan recommends that the Fund, in close cooperation with the World Bank and other multilateral development banks, give greater attention in debtor countries to structural and institutional measures such as tax reform, market-oriented pricing, the reduction of labor market rigidities, and the opening of economies to foreign trade and investment.

Some details of the U.S. initiative are set out below. The proposals are at a preliminary stage and should be seen primarily as illustrating the need for financing to countries implementing appropriate economic policies. Thus, the U.S. initiative seeks to address directly the concern about the prospects for capital market flows identified in the staff report on "International Capital Markets - Developments and Prospects, 1985" (SM/85/267). Specifically, the staff report emphasizes that a central task in the period ahead relates to the need to stimulate adequate financing flows. Moreover, the staff report points out that banks, by demonstrating responsibility and flexibility where adjustment efforts are underway, can protect the quality of their existing claims on developing countries as well as contribute to further progress in reducing systemic risk and restoring sustainable growth.

## II. New Financing Flows

### 1. The role of the multilateral institutions

The proposal supports the role that has been played by the Fund in encouraging policy changes and catalyzing capital flows to debtor countries, and envisages a continued important role for the Fund in both respects. In this connection, it was noted that the development by the Fund of new techniques, such as "enhanced surveillance," could be useful in certain cases in generating additional financing to support further progress in borrowing countries.

The adoption by debtor countries of economic reforms would also be supported by an increase in structural and sectoral loans from the World Bank and other multilateral development banks. The U.S. has suggested that annual disbursements from the World Bank and Inter American Development Bank to principal debtor countries could increase by about 50 percent from the current level of nearly US$6 billion in support of structural policy changes in debtor countries. If the principal debtors implement growth-oriented reforms, commercial banks provide adequate increases in net new lending, and increased demand for quality World Bank lending demonstrates the need for increased capital resources, the United States would be prepared to look seriously at the timing and scope of a general capital increase for the World Bank. The United States also proposed that the Inter American Development Bank should strengthen its lending policies to give more effective support to growth-oriented structural reform and on this basis to introduce a program of targeted nonproject lending.

The World Bank role in stimulating private lending to developing countries would be enhanced under the U.S. proposal, with strong support for an expansion in the Bank's cofinancing operations. In addition, the proposal anticipates that the operations of both the recently negotiated Multilateral Investment Guarantee Agency (MIGA) and of the International Finance Corporation will assist in attracting nondebt capital flows to member countries.

2. Commercial bank lending

The U.S. initiative is aimed at overcoming an increasing reluctance among banks to participate in new money packages and debt restructuring, and at reversing the sharp decline in net new bank lending to debtor countries. It envisages a public commitment from the banking community to provide net new lending of US$20 billion to a group of 15 heavily indebted, middle-income developing countries over the period 1986-88, provided that sound economic policies are put into place. U.S. officials have indicated that this would represent an increase on the order of 2 1/2-3 percent a year in total commercial bank claims on the group of countries. In addition to the provision of new loans to the group of 15 countries, banks would be asked to continue to provide net new loans to countries now receiving adequate bank financing on a voluntary basis, provided that these countries maintain sound policies, and to consider lending to other developing countries experiencing debt servicing problems that require relatively small amounts of commercial bank financing under agreed adjustment programs.

The U.S. Treasury has indicated that a variety of techniques for generating the new bank lending could be considered. At this stage, the Secretary of the Treasury has invited suggestions from the banking community about possible arrangements to ensure that an adequate flow of new financing is obtained.

3. Other private financing

The U.S. plan stresses that other sources of external finance, including foreign equity investment, private sector borrowing, and repatriation of domestic capital must also be encouraged. This should be facilitated by the implementation of sound economic policies to stimulate growth and investment, and would also be encouraged by the expansion of the role of multilateral institutions described above. In particular, policy measures must succeed in reversing capital flight if foreign financing is to increase. The U.S. Treasury Secretary also laid emphasis on the importance of enhancing foreign direct investment. He noted that it is not debt-creating, that it may have a compounding effect on growth, as well as bringing new technology and innovation into recipient countries, and that this may help to keep capital at home.

Mr. Finch

# Office Memorandum

TO: The Deputy Managing Director

November 1, 1985

FROM: C.M. Watson

SUBJECT: Debt Outlook for Selected Countries

As you asked, we have examined the area department responses to your request for information on the debt outlook for the 15 countries covered by the Baker initiative. Simply tabulating the net changes in bank exposure specified in the staff projections does not really provide helpful results (attachment). On that basis, there would be almost no change over the three years in bank exposure to the 15 countries (and indeed that is consistent with the projections in the latest WEO). However, departmental submissions indicate unfinanced gaps for several countries (notably, Ivory Coast, Mexico, and Nigeria) which may be filled by bank financing. Moreover, for Argentina the aggregate financing need is currently being revised upward. Therefore, we have tried to derive some judgmental implications for bank financing from the memoranda provided by departments.

1. It is clear that there is an extremely wide range of uncertainty about the order of magnitude of net new bank lending to the 15 countries over the period 1986-88. On the basis of the memoranda provided by area departments, net bank financing for these 15 countries in aggregate could vary from as little as US$5 billion to more than US$20 billion. There are several reasons for this degree of uncertainty:

a. For a number of countries, the submissions imply a range of possible financing levels. In the case of Venezuela, for example, two scenarios are presented by the staff. In the first of these, net bank exposure is reduced by US$5.7 billion (20 percent) over the period, as no new gross disbursements are assumed from the banks, whereas in the second scenario, bank exposure is unchanged. In other cases, such as Argentina and Mexico, there is divergence between projections made by the authorities and the views of the staff.

b. There are several countries (such as Ivory Coast) for which financing gaps remain in the projections, and the figures in the table would indicate a reduction in bank exposure equal to the amount of scheduled amortization due to banks. In these cases, it appears likely that the banks will contribute to closing the gap either by rescheduling (which would leave net exposure unchanged), or through new money packages, or a combination of both.

c. There are other cases, for example, Brazil and the Philippines, where no increase in exposure over the period is projected, but changed financing needs would critically affect the overall amount of bank lending to the group as a whole.

2. The exercise illustrates that the fifteen countries will have very varied financing requirements, with a considerable divergence in the net bank lending that they are projected to receive over the three-year period. For example, a possible reduction in bank exposure is shown for Colombia, whereas a substantial increase is projected for Argentina.

3. A number of key countries are likely to be approaching banks with requests for new money before the end of 1986, including Argentina, Chile, and Mexico. Some countries, such as Ecuador, may be able to arrange new financing through an approach to a limited group of banks. In other cases the staff believes that there may be considerable problems in such an approach, but expresses serious concern also about the viability of seeking agreement on new money from all banks.

4. There may be a significant difference between the amount of new money for which banks are approached and the underlying net change in bank exposure. In the case of Colombia, where a debt rescheduling is not involved, it is envisaged that bank exposure will decline over the period despite substantial gross disbursements of new money. In other cases, for example Argentina, debt rescheduling is not projected to cover all the obligations falling due, in which case the new money need would be larger than the net increase in exposure.

In sum, this preliminary exercise underscores the substantial uncertainties inherent in current projections for individual countries, and thus in the outlook for aggregate lending to the group covered by the U.S. initiative. Some of these uncertainties reflect the lack of time for analysis of country situations. More fundamentally, the appraisal of individual countries' needs will clearly have to be developed over time on a case-by-case basis. For each country, the availability of financing will depend crucially on the implementation of appropriate policies, while the need for financing will depend both on domestic policies and on external developments. Moreover, countries' expectations may be affected in different ways by the Baker initiative itself. In particular, countries hitherto projected to hold constant or reduce their net bank liabilities may now plan to seek net new money from banks.

Attachment

cc: Mr. Finch

Table . Projected Net Changes in Commercial Bank Exposure to Selected Countries, 1986-88

(In billions of U.S. dollars)

| | 1986 | 1987 | 1988 |
|---|---|---|---|
| Argentina 1/ | 1.0 | 0.4 | 0.2 |
| Bolivia | 0.2 2/ | -- | -- |
| Brazil | -- | -- | -- |
| Chile | 0.4 | 0.1 3/ | 0.1 3/ |
| Colombia | 0.1 | -0.1 | -0.2 |
| Ecuador | -- | -0.1 | -0.2 |
| Ivory Coast | -0.3 4/ | -0.3 4/ | -0.3 4/ |
| Mexico | 1.8 | -0.5 4/ | -1.0 4/ |
| Morocco | 0.2 | -- | -0.2 |
| Nigeria | 0.7 | 0.5 4/5/ | 0.2 4/5/ |
| Peru 6/ | -- | -- | -- |
| Philippines | -- | -- | -- |
| Uruguay | -- | -- | -- |
| Venezuela | | | |
| Scenario A | -2.0 | -1.7 | -1.9 |
| Scenario B | -- | -- | -- |
| Yugoslavia | -- | -- | 0.6 |

Source: Staff estimates.

1/ Projections for 1986 come from table submitted by WHD in Seoul; figures for 1987-88 are from latest staff report (since then, staff estimates of net new bank financing have risen).
2/ Capitalization of interest arrears at end-1985 equivalent to US$246 million.
3/ Assumes banks fill financing gap presently expected for 1987-88.
4/ Unfilled financing gap projected in this year.
5/ Financing gap projected, after 100 percent rescheduling of amortization due to banks.
6/ Excludes projected US$1.2 billion increase in interest arrears to banks.

Mr. Watson / Kincaid

# Office Memorandum

October 25, 1985

TO: Heads of Area Departments:
AFR, ASD, EUR, WHD

FROM: The Deputy Managing Director

SUBJECT: Debt Outlook for Selected Countries

I should be very grateful if you could provide information concerning the outlook for external indebtedness and financing flows for countries in your department which are included in the list for the U.S. debt initiative. These countries are Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Ivory Coast, Mexico, Morocco, Nigeria, Peru, Philippines, Uruguay, Venezuela, and Yugoslavia.

For each country, and using tables already available, would you please provide debt and balance of payments data covering the years 1985 through 1988. Regarding debt data, it would be helpful to have an analysis by creditor group, including as much detail as feasible. It would also be useful if the balance of payments outlook for these years included available detail on debt-servicing components. In particular, it would be important to identify the gross as well as the net financing requirement from commercial banks.

Would you please provide also for each country a brief assessment of the prospects for raising commercial finance on the scale indicated in the tables. An important question is whether these amounts might be raised from a limited group of banks with longer term business interests in the country, or whether it might prove difficult to secure this financing without agreement to participate from the entire group of bank creditors. Clearly it is hard to assess the financing outlook in the abstract, but it would appear useful to work on a basis that the country would have established an appropriate set of policies; that banks in major countries would be encouraged by their authorities to participate in new financing which could result in a modest increase in their exposure; but that forceful pressure from governments or generalized guarantees would not be in prospect. If one or two particularly difficult aspects of an approach to commercial banks can be identified at this stage, it would be helpful to indicate these.

It would also be helpful to know the extent of World Bank involvement as foreseen before the Annual Meetings, and the prospects for additional World Bank lending in light of the decision taken at the Annual Meetings to increase the scale of World Bank financing. Any views on other sources of official lending would be useful.

Finally, would you please indicate when the next negotiation on a program with the Fund or major mid-term review of an existing program is scheduled, and when the next approach to commercial banks for new money or rescheduling is expected. Please indicate the periods expected to be covered by the Fund program, and by the commercial bank financing, respectively.

cc: The Managing Director (o/r)
Mr. Finch
Mr. Habermeier
Mr. Hood
Mr. Shaalan
Mr. Brown

INTERNATIONAL MONETARY FUND
WASHINGTON, D. C. 20431

OFFICE OF THE
MANAGING DIRECTOR

CABLE ADDRESS
INTERFUND

October 30, 1985

MEMORANDUM

RECEIVED
OCT 31 1985
EXCHANGE &
TRADE RELATIONS

To: Mr. Erb
Mr. Finch
Mr. Whittome
Mr. Hood
Mr. Mohammed
Mr. Nicoletopoulos
Mr. Van Houtven
Mr. Wiesner
Mr. Beza
Mr. Habermeier
Mr. Kincaid
Mr. Watson

From: Robert M.G. Brown Robert M.G. Brown

I have been asked to circulate the attached note of the meeting on debt issues chaired by the Managing Director on Tuesday, October 22, 1985.

Attachment

## Meeting to Discuss Current Debt Issues

The Managing Director chaired a staff meeting on October 22, 1985 to review developments in the debt situation. Discussion focussed principally on issues identified in the Managing Director's memorandum of October 21, including in particular the way in which the U.S. Treasury initiative on debt problems could be carried forward. A number of main conclusions emerged from the meeting.

1. The central task of the period ahead would be to build on the progress achieved so far in resolving debt difficulties, addressing economic policy reforms and financing needs in member countries on a case-by-case basis. A key objective would be to foster a return to sustainable and more satisfactory growth rates in debtor countries. There was a clear desire that the Fund should continue to play a central role in supporting this process, and that there should be increasingly effective participation by the multilateral development banks.

2. While the key to achieving progress would lie in the implementation of effective policies by member countries, a major challenge would be to find the best ways to organize financial support for these endeavors. Discussions with officials and bankers had revealed a very broad consensus that new private as well as official financing must contribute to supporting policies in member countries that were designed to foster sustainable economic growth. In this regard, the initiative launched by Secretary Baker had provided a most important signal to the international community. The task now would be to translate this into practice on a case-by-case basis.

3. To muster support for this approach, it would be crucial that governments in the industrial countries give their banks firm indications with regard to the way ahead. Governments would need to be clear with banks about the nature and scale of official participation in this strategy. There must be clear evidence that the World Bank's involvement would be substantial, providing additional financing in support of well-targeted objectives. Guarantees of bank financing on a generalized basis were not in prospect. However, the contribution of export credit agencies would be important; these agencies would need to be closely involved in the financing process, and their contribution would need to be carefully organized and monitored.

4. Governments would need to ensure also that bank regulators extend the flexibility that they had shown in the early stages of the debt crisis, so that efforts to improve the position of banks did not cause the banks in practice to curtail their lending in a counter-productive fashion. New lending in support of sound policies would protect banks' existing assets, while strengthening the international financial system in an indispensible manner.

5. Considerable difficulties had been encountered in mustering concerted lending from the totality of a country's creditor banks,

despite countries' commitment to implement painful economic reforms. An issue to be addressed urgently was what modalities could facilitate such financing.

6. For countries expected to return to the credit markets in due course, it appeared essential that the bulk of the additional financing from commercial banks take the form of lending on market-related terms. To engage in large scale interest capitalization for such countries would move them farther away from a return to the markets, might encourage a unilateral approach to debt rescheduling, and could lead to debt being "rolled up" without the implementation of policies that would enhance the countries' debt servicing capacity. Thus, a priority would be for major international banks to continue to commit funds for such countries in the form of new money packages.

7. While there was agreement on the way in which major banks should be asked to participate, the meeting identified difficult issues as regards the manner in which smaller banks should be treated. This subject was considered to require further careful study, but some priorities could nonetheless be identified at this stage.

8. For countries relatively well advanced in the adjustment process, and whose financing needs were modest in absolute terms, there was a strong case for seeking to assemble bank financing from a limited group of banks that were keen to pursue long-term business involvement in the country concerned. Countries such as Colombia, Ecuador, and Uruguay were mentioned as potentially being in this category (together with Venezuela, should it seek to raise new commercial financing). Such financing would involve coordination, but not the arduous task of securing agreement on concerted lending from all bank creditors. One objective--and incentive--for debtor countries would be to implement policies that carried sufficient conviction with international banks to allow their graduation to this form of quasi-spontaneous financing.

9. More difficult issues arose in the case of countries that had not yet reached this stage of the adjustment process, or where policy slippages or adverse developments had caused a sense of renewed unease in the banking community. It would clearly be desirable to present countries such as Mexico and Argentina also as having achieved sufficient success that the concertation of packages with all bank creditors could be dispensed with, and financing needs met by a group of major international banks. But the Managing Director warned that his contacts in the past days signaled reluctance on the part of some European banks to accept an approach under which they were obliged to participate in financing for these countries, while small banks were allowed to stand back and receive their interest payments in full. European banks had emphasized that the nonparticipation of U.S. regional banks, for example, would substantially change the national distribution of burden-sharing.

10. To meet this concern about the withdrawal of regional banks, one possibility would be to agree on the existing national distribution of lending, but to leave each national group of banks to decide on the burden-sharing within their own community. However, it was noted that some national groups (Spanish banks, for example) showed a general reluctance to participate in new money packages, and this raised questions about the viability of such an approach.

11. To the extent that financing packages for some debtor countries might not be possible if smaller banks were allowed to avoid participation without penalty, it thus appeared important to study potential means of allowing such banks to participate in the burden-sharing by alternative modalities to the new money approach. The meeting therefore reviewed possible innovations in the concerted lending approach that might facilitate participation by smaller banks, but without involving a generalized spread of interest capitalization.

12. In this regard, a possibility was to structure new money/rescheduling packages in a way that offered smaller banks instruments or types of claims that they would be more ready to accept. Several variants on this approach were reviewed.

a. First, the new money package might take the form of (or include for smaller banks) a country-specific trust fund on which claims could be held, in part to manifest the special nature of these new claims vis-a-vis the regulatory authorities.

b. Second, debtor countries might be prepared to follow the Chilean example of allowing banks to take equity claims on entities in the debtor country, in lieu of the rescheduled debt and associated new money obligations. To the extent debtor countries could accept this, it appeared highly attractive. It offered a chance to reduce the indebtedness of the country, while involving banks in longer term investment including possibly the privatization of parastatal bodies. There might be scope for the IFC to play a valuable role in assisting the process of transforming debt into equity, through country-specific investment funds set up for this purpose.

c. Third, the possibility of issuing "exit bonds" at a discount to smaller banks should be studied. Such bonds would allow smaller banks to withdraw while reducing the debt load of the country. But it was difficult to imagine the issuance of such bonds on a large scale, not least because of the possible implications of discounts on such bonds for the valuation of other banks' claims on the countries.

d. Finally, the possibility of allowing smaller banks to participate through some form of interest rescheduling should not be ruled out, possibly through the country trust fund approach outlined in a. above. However, the dangers of this becoming more generalized in the minds of some banks and some debtor countries needs to be borne carefully in mind.

13. These possible modalities should be examined carefully, with a view to determining to what degree they would genuinely facilitate the participation of smaller banks. Moreover, it would be important to review the question that some banks had raised about the base date for exposure to countries. There was some feeling that the original base dates were increasingly artificial, but a countervailing concern that moving the base date forward would reward banks that had failed to participate in new lending and penalize those that had commited spontaneous trade financing.

14. The Managing Director said that he would be in touch with the U.S. authorities in the coming days to explore these issues further, with a view to formulating concrete proposals that might be adopted for the cases of Mexico and Argentina. A high priority now would be early consultations with key industrial countries to secure their general support.

INTERNATIONAL MONETARY FUND

October 30, 1985

Mr. Finch:

You may like to glance at the Managing Director's comments on the note on new money packages. He is clearly very negative on the likelihood of dealing with Mexico or Argentina on the basis of a limited group of banks. This is consistent with the general thrust of the memorandum (which is contingency planning against precisely that possibility). However, I remain of the belief that one should not dismiss the concept of a limited group for Mexico until one is absolutely sure that a better alternative has been found.

You may like to pass on to the area departments concerned a copy of this note and the comments so that they are aware of the Managing Director's reactions.

Attachment

C. Maxwell Watson

# *Office Memorandum*

To: The Deputy Managing Director  October 25, 1985

From: C. M. Watson

Subject: New Money Packages: A Possible Approach

You asked us to conduct a preliminary review of ways in which the present new money approach might be developed as part of arrangements to implement the Baker initiative. This general approach is predicated on three assumptions:

-- The United States now takes effective action to rally other major countries behind the new money approach, and these countries advise their banks to cooperate in this approach.

-- The debtor countries proceed to implement appropriate policies to strengthen their external payments position and resume sustainable growth.

-- The official sector demonstrates its willingness to engage in burden-sharing through a commitment to increase the World Bank's capital, through export credit cover policies, and through avoidance of counterproductive bank supervisory practices.

On these assumptions, an urgent problem facing the international banking community is how to evolve the present concerted lending approach, to streamline the increasingly lengthy and difficult process of securing new money commitments from the totality of a country's bank creditors.

The attached technical memorandum addresses this issue, and builds on the conclusions and priorities established at the Managing Director's meeting on October 22. In essence, the overwhelmingly preferable approach to raising new money in the current environment is to seek to involve a more limited group of banks than hitherto. Such a group would be based on the principal bank creditors of a country, who normally will have a longer term commitment to business with the country, and significantly more to lose if a solution is not found. Cofinancing with multilateral development banks, facilities related to trade transactions, and on-lending options may play a part in such packages.

Nonetheless, there may be cases involving key debtor countries where some significant bank creditors refuse to allow banks with smaller exposures (often large banks) to avoid the commitment of new money yet receive their interest payments in full. In such cases, a further evolution of the present approach may be necessary. Rescheduling and new money packages are already being made more flexible, involving various options (including equity participations, in the case of Chile). However, a significant number of smaller banks might still fail to participate through these types of options.

** (see over page)

In that case, a further option could be introduced into reschedulings which would involve recycling of a portion of interest payments below a certain ceiling, without the formal advance of new money by banks with smaller exposures. To present this as a market-related mechanism, it could be treated as one of several (limited) options, including for example, an equity fund. Conceivably, this might be effected through country-specific trusts located outside the debtor country.

Attachment

cc: Mr. Finch (o/r)
Mr. Beveridge
Mr. Brown

** I disagree with this too general statement. It does not reflect the position of a number of banks (especially outside the U.S.). The "cut-off" line would be difficult to mark if smaller countries were to be "exempted". A "preferable" solution must also be workable.

ATTACHMENT

## Background Note on Developments in the New Money Approach

This memorandum discusses ways in which the present new money approach might be adapted to the circumstances of different countries and the business interests of creditor banks. First, it reviews the general question of tailoring financing approaches to countries' payments situations. Second, it assesses the significance of the recent evolution in restructuring and new money techniques. Third, it discusses the issue of raising new money for countries where equitable burden-sharing is still an issue. Finally, possible future options to facilitate participation by banks with smaller exposures are given a preliminary review.

### 1. Tailoring the financing approach to country situations

The Baker initiative emphasizes that economic policy reforms and financing should continue to be assessed strictly on a case-by-case basis. In the period ahead, net financing needs from private creditors will clearly emerge in countries whose payments prospects vary widely. If the approach to filling these financing gaps is to be realistic, it will be important to appraise what modality of financing is best suited to each country's prospects. Even within the Baker group of 15 countries 1/, a case such as Bolivia is one where we know that leading banks are contemplating addressing the problem of accumulated interest arrears by interest rescheduling on concessional terms. Thus, it is important to try to group countries broadly according to the types of finance that they can reasonably hope to access in the years ahead. Of course, grouping countries in this way will need to be presented in a positive manner: there will be an incentive for countries to progress toward enhanced relations with creditors over time as their prospects improve.

a. A first group of countries (including Hungary, Korea and Indonesia, for example) has access to spontaneous financing. The Baker speech made clear that a reasonable flow of financing in support of appropriate policies in these countries was assumed to take place outside the scope of the $20 billion objective for the 15 countries experiencing payments difficulties. Vigilance may be needed on the part of national authorities to ensure that injudicious actions by major banks do not jeopardize spontaneous flows to these countries.

b. Countries in a second group have been experiencing payments difficulties, having recourse in several cases to concerted lending, but have advanced in the adjustment process to a point where it may be possible to raise new bank finance on a quasi-spontaneous basis. This could be achieved through "club" deals involving a limited number of

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1/ Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Ivory Coast, Mexico, Morocco, Nigeria, Peru, Philippines, Uruguay, Venezuela, and Yugoslavia.

*** It is most unrealistic to put Morocco-- and even Yugoslavia or Ivory Coast-- in such a group.



**** What about the European and Japanese argument--"we don't want to pay for the U.S. regional banks"?

banks having longer term business interests in the country. This approach will be easiest where the absolute size of the net financing requirement is relatively modest.

In some such cases, particular financing vehicles (such as trade facilities) may be oriented to the preferences of identified groups of banks. In some cases, World Bank involvement through cofinancing may offer a possible route, although there are worries that politically damaging pressures could emerge for the World Bank to extend guarantees on a generalized basis. This group of countries may include Colombia, Ecuador, Venezuela (to the extent new financing is needed), and Yugoslavia. It is conceivable that the needs of Ivory Coast and Morocco might also be addressed in part through cofinancing.

*** It is most unrealistic to put Morocco or even Ivory Coast or Yugoslavia in such a group.

The approach involving a limited bank group has tremendous advantages. It can generally be presented as representing important progress in moving back toward market-based decision making, as part of the process of rebuilding countries' payments relations with their creditors. Moreover, there is as yet no really satisfactory approach to resolving the problem of recalcitrant bank creditors, which has been threatening the viability of the concerted lending process. So attractive is this route that it would seem worth exploring carefully with banks whether cases such as Argentina or Mexico cannot be handled by variants on this approach.

**** What about the European and Japanese argument: "we don't want to pay for the US regional banks"?

To encourage adoption of such an approach, authorities in financial market countries could stress to banks that this would be implemented on a strictly case-by-case basis as regards debtor countries, so that the group of leading bank creditors would vary between the cases. Thus, those mid-sized banks who would most resent inclusion would find that they were asked to participate only in packages where their exposure was larger (and their own commitment possibly slightly greater).

c. There may well be countries (such as Chile and the Philippines) where further lending packages will not attract support from key bank creditors if it is clear that banks with mid-sized and small exposures are to be released from the new money process while still receiving their interest payments in full. Thus, a third group of countries comprises those where the assembly of new money packages will need to take into account some burden-sharing on the part of banks with small exposures. The issues raised by this problem are complex, and are addressed in the third section of this memorandum.

d. A fourth group of countries may comprise those where net financing requirements can be held to a level that will be satisfied by rescheduling of principal payments to commercial banks, together with substantial support from the official sector. At the same time, one should bear in mind that even in these cases, the rescheduling process has also become more strained for some countries. Some support from industrial country governments may be needed to urge recalcitrant banks to cooperate when countries are engaged in implementing appropriate policies.

e. A fifth and final group comprises countries whose debt load appears unviable in terms of likely balance of payments developments, even given satisfactory economic policies. As discussed above, Bolivia is a case in point. Contacts with banks, including some in the past few days, indicate a growing support for the idea that, where such countries embark on an entirely new phase of political and economic management, banks may consider rescheduling past interest arrears on terms including significant grace periods and fixed interest rates.

The question arises whether countries in this last group have any prospect of regaining access to medium-term bank lending in the foreseeable future, bearing in mind that very substantial provisions have been made in some cases (even by U.S. banks). Given sound policies and a cleaning up of existing debt, a return to medium-term flows over the course of a number of years may be feasible. For the moment, actions should concentrate on mustering adequate trade and, where possible, project financing, with the support of resumed official export credit cover. If, in such cases, the prospective net financing need (after rescheduling of arrears) implies an additional contribution from private creditors, further rescheduling of current interest on medium-term finance may perhaps be necessary on an exceptional basis.

2. Evolving techniques for rescheduling and new money

In considering how techniques for restructuring and new money might evolve, it is interesting to note the degree of constructive development which has already occurred during the past two years. Table 1 provides preliminary information on the extent to which recent restructurings have included provisions for relending, on-lending, currency redenomination, World Bank involvement, use of trade-related facilities with advance disbursement, and exchange of debt for equity.

One important aspect of these developments is that they are building on the longer term interests of banks in the debtor country. Thus, relending and on-lending allow banks to develop or renew their relationship with parastatal bodies and private sector corporations. Currency redenomination may be seen as aligning banks' cross-border lending with their domestic capital and funding base. World Bank involvement builds helpfully on the principle that the core of medium-term flows in the future may lie in project-related lending, and that appraisal of projects and sector policies by the World Bank can play an important role in improving the use of foreign savings.

It has serious drawbacks.

Exchanges of debt for equity provide a formal claim which would be unusual for some national groups of banks (although quite customary for others, such as German banks). But such exchanges do meet the criticism of smaller banks that they believe further debt financing to be inappropriate. They could help supply capital in those cases--possibly very limited--where countries are prepared to allow greater foreign equity participation, possibly facilitating in that context the privatization of parastatals.

-- There are, of course, natural limits to the use of these options at any early date. In general, the funds being made available under new money packages are needed for general purpose balance of payments finance. To the extent funds under the options outlined above represent a predisbursement of financing that will, in due course, support imports (or projects that will require additional foreign exchange expenditures), all that is being achieved is a once for all liquidity gain by advancing the disbursements. Nonetheless, these routes may facilitate participation by banks, and do seem attractive as options provided they are subject, where appropriate, to ceilings on use in any time period.

3. Raising new money for countries where equitable burden-sharing is still an issue

As discussed above, the problems encountered in raising new financing commitments from the entirety of a country's bank creditors have become extremely serious. Recent examples include Chile, Ecuador, and Panama, where a minority of banks have held up completion of packages supporting policies designed to underpin a substantial improvement in the quality of their claims on the country. Because of these problems, it would seem highly desirable to find ways of either allowing small banks to drop out of the process--given that their financial contribution is in some cases neglible--or to find modalities that allow them to participate in burden sharing on a basis more acceptable than the provision of "new money."

In practical terms? Not so sure.

in practical terms? Not so sure

?

The ideal solution to the difficulties now faced would be to present packages for all countries needing concerted financing on the basis of participation by a limited group of banks. As discussed at the Managing Director's meeting on October 22, however, soundings with European banks have given rise to concern that they would be unwilling to see smaller banks withdraw--and that notably there is unwillingness to see a withdrawal by U.S. regional banks increasing the burden sharing for banks in Europe.

indeed

Indeed

a. Burden-sharing between national groups of banks

If this problem related solely to national burden sharing, a possible solution would be to establish the shares for creditor banks in different countries, and leave it to those banks to distribute the burden among their own community.

However, there are some countries where banks generally are highly resistant to the idea of new money packages. This is clearest in Spain, although other cases such as Norway have been mentioned. The pattern varies from restructuring to restructuring, with Italian banks favorable for lending to Yugoslavia, but less favorable in some other cases. Thus, in each restructuring there are likely to be several nationalities of banks where the larger claim holders are unwilling to take on the task of sorting out burden sharing in their community.

b. Problems of cut-off point

It is not clear that the issue of national burden sharing is the only problem arising from withdrawal of smaller banks. For example, in Germany the Bavarian banks would doubtless be very unwilling to participate in new money packages, thereby significantly increasing the burden sharing for the other German banks. Moreover, wherever the cut-off line is drawn in terms of size, even if this falls differently for each debtor country, there is bound to be considerable resistance from banks whose exposure is almost small enough to fall below the cut-off line. Indeed, one might wonder whether this approach would induce such banks to swap or sell debt on an increased scale.

c. Availability of payments relief

One further consideration arises if smaller banks are to receive interest payments in cases where countries are still facing very serious difficulties. Quite a number of smaller banks may be prepared to cooperate in providing payments relief by any modality other than new loans which require a formal recommendation to their boards of directors and need to be justified to shareholders. Thus, by failing to involve such banks, one is also foregoing some degree of payments relief, or causing even larger increases for other banks. In this regard, the Mexico example underscores that the gross financing needed to achieve any increase in exposure may be quite substantial. Letting out smaller banks will make this harder to justify to major banks' boards.

These considerations lead one to reflect on ways in which the cooperation of smaller banks could be secured in burden-sharing for certain countries.

4. Claims designed to meet the needs of banks with small exposures

The question whether claims can be provided in a form more acceptable to banks with small exposures is one of central importance. If the answer to this question is negative, then there is a straight choice between moving to a limited group of banks for a new money package, or accepting that the new money may only be available after protracted delays, as the process of erosion of participation by small creditors gradually takes place and is accepted.

The options outlined in section 2, which have already been included in some rescheduling or new money agreements, generally may not meet the needs of banks with very small exposures, whose interest in longer term relationships in the debtor country may be nonexistent. The question therefore arises whether further options could be introduced to facilitate participation by these banks, without leading to generalized approaches that could damage the rebuilding of payments relations.

A first question to be addressed is the nature of the problems which are causing banks with small exposures to resist the new money process. Broadly, these can be analyzed in three categories:

-- A reluctance on the part of senior management in banks to approach their boards of directors with proposals to lend to countries whose problems are well publicized, partly reflecting concern about shareholder reaction to such lending.

-- In some cases, a genuine belief that new lending is an inappropriate form of payments relief for countries where difficulties are likely to be protracted, and that deferment or reduction of interest would be a more appropriate response. The concern that interest deferment would be a more appropriate way to deal with the problem is somewhat disingenuous, since capitalization increases the debt load of the country, but in a less active way (an approach that has clear dangers). Among some banks, however, there is a willingness to reduce the interest rate for some countries, but this mainly relates to countries in very protracted payments difficulties such as Bolivia or the Sudan.

-- Serious frustration with the leadership of major U.S. banks, who are seen by some banks as a desiring to show misleadingly high interest receipts on loans to problem countries (a sensitivity which is the more acute where U.S. banks are also seen as desiring to penetrate regional or foreign banking markets).

In general, these concerns will only be met by an improvement in the debtor countries' position so striking as to clearly validate the new lending that has taken place. Indeed, in the Spring of this year, some German bankers were prepared to acknowledge that interest capitalization might have been inappropriate for Mexico or Brazil.

More specifically, the response of banks to an increased flexibility in the modalities of restructurings and new money packages will vary considerably depending on the degree to which their dissent reflects each of the factors mentioned above. It is our assessment that the principal obstacle to participation in new money packages by small banks is a managerial one. There is a desire not to present proposals for new loans to questionable borrowers, because of the possible adverse effects of association with such lending and a belief that nonparticipation will not materially damage the economic position of the bank.

Where the banks have an objection in principle to advancing further debt finance, the provision of an equity option may give some reassurance. But in the case of many smaller banks, the course that would most facilitate their participation would be a modality whereby part of their interest receipts would be recycled directly to the debtor country without the need for full review of a new loan by credit committees and boards. The question is whether techniques for achieving this can be devised without resulting in a more general shift toward interest capitalization or seriously affecting the valuation of claims by some key banks which are not in a position to make provisions on the scale implied.

To minimize the negative impact of recycling interest payments due to certain banks, it would be possible to contrive modalities whereby such interest was paid in full at source, but then part of it was recycled to the debtor country by an intermediary body on behalf of the banks with small exposures. This would amount to an accounting illusion, whereby the country was seen to pay interest in full, but the flow was interrupted to avoid the need for formal commitment of new money by the banks concerned.

Under such an arrangement, these banks could hold claims on a trust fund located outside the debtor country in various forms. The simplest would be a book claim, on which interest payments would be made net of any recycling; the holders' claims on the fund would rise in proportion to the amounts recycled. Alternatively, more complex arrangements could be devised, under which the claims on the fund were transferable, and would thus constitute "exit bonds". Of course, widespread issuance of "exit bonds" at a deep discount could lead to a decline in confidence as regards the creditworthiness of a country and pose serious problems as regards the valuation of other banks' claims on the country.

In order to limit the amount of such participations, and to preserve the appearance of a relatively integrated restructuring package, such arrangements could be presented as one among several options in a restructuring packages. Most of the options would have ceilings on utilization, applied either by creditor or in aggregate. In the case of a recycling fund, it would appear appropriate to apply the ceilings on a creditor basis, so that smaller banks could in practice convert all of their claims, but the bulk of the funds would be lent directly to the country in the form of a traditional new money package.

If it were judged that cases may arise in the near future where new money packages will again need to involve the totality of a country's creditor banks, it would appear worth considering inviting a group of bankers and lawyers to examine arrangements that could operate along these lines. Such a technical study could be valuable, but it would be important to place it in a broader perspective. Three considerations would remain particularly important:

-- While more flexible technical modalities may assist in this process, a key determinant of success will be the degree to which authorities in industrial countries actually support efforts to muster new financing. In some cases, it is clear that the Fund has not been benefiting from the support of monetary authorities, who have taken a detached attitude to the new money process.

-- Modalities designed to encourage participation by smaller banks could spread by contagion, resulting (for example) in a generalized adoption of interest capitalization.

-- The modalities adopted to facilitate participation in burden-sharing by smaller banks should not result in a shift away from a country-by-country approach to assembling financial packages.

Table 1. Special Financial Modalities in Selected Restructurings, 1983-85

| | Re-lending/ On-lending | Currency Redenomination | World Bank Involvement | Trade-Related Facility 1/ | Exchange for Equity |
|---|---|---|---|---|---|
| Argentina | NM 84 | R 85 | | NM 84 | |
| Brazil | 83, 84 | | | | |
| Chile | NM 85 | | NM 85 | | R 85 |
| Colombia | | | NM 85 | | |
| Ecuador | D 83 | R 85 | | NM 83 3/ | |
| Ivory Coast | | R 85 | | | |
| Mexico | | R 85 | | | |
| Philippines | NM 85 | R 84 2/ | | (NM 85) | |
| Venezuela | R 85 2/ | R 85 2/ | | | |

Sources: Debt restructuring and new money agreements.

Note: Restructurings (R), New Money Packages (NM), and Deposit Facilities (D).

1/ In connection with new money packages.
2/ Agreement in principle.
3/ A trade credit maintenance facility was signed in connection with a new money agreement.

Mr. Finch

**INTERNATIONAL MONETARY FUND**

October 24, 1985

Deputy Managing Director:

The attached memorandum corrects and completes data provided to you on interest payment ratios for countries included in the Baker initiative.

As you know, a full scale exercise on interest ratios is in hand, which should result in more satisfactory figures than those attached.

Attachment
cc: Mr. Finch
Ms. Dillon
Mr. Brown

**C. Maxwell Watson**

# *Office Memorandum*

To: Mr. Watson  October 23, 1985

From: Caroline Atkinson and Bruno de Schaetzen

Subject: Interest Payments Ratios

Attached is the table that you requested showing interest payment ratios for selected debtor countries. Although we have attempted to provide figures that are on a comparable basis, and are consistent with those being collected in the exercise now underway in the External Finance Division, this has not always been possible.

To some extent this is a timing problem. In some cases, the latest estimates available from ETR economists for either exports or interest payments have been revised from those provided to EFD. In other cases, we have had to use data for the medium-term projections which have been revised less recently than the 1984-85 data. In addition, several of the economists supplying the information warned that it may soon change as a result of updating on missions that are due shortly.

There is also an overall problem of consistency. It is not clear, for example, whether the underlying assumptions for export prices or interest rates are the same for different countries in the group, or whether the financing terms implicit in the medium-term projections reflect similar assumptions.

In addition, there may be some definitional differences between the export figures generally used here and those used in other staff tables (which may for example, include all service credits or private transfers in the denominator).

A further problem is that the figures for private sector interest payments have, in many cases, been estimated from a weak data base. This is especially important for the major Latin American countries with a large outstanding stock of private sector debt.

Finally, in a broader sense, the ratio of interest payments to exports may not be the best indicator by which to group debtor countries. It is essentially an indicator of short-term liquidity problems, rather than a measure of long-term solvency. A better guide to the latter would be the ratio of interest payments to GDP. This measure shows the proportion of a country's total resources that would be needed to maintain interest payments in the future, and thus indicates the degree of adjustment that may be required to meet such payments.

Attachment

tbakrtb3 (TBL)
October 23, 1985

Table . Interest Payments as Percentage of Exports of Goods and Nonfactor Services in Selected Countries, 1984-88 1/

(In percent)

| | Estimates | Projections | | | |
|---|---|---|---|---|---|
| | 1984 | 1985 | 1986 | 1987 | 1988 |
| Argentina 2/ | 48.3 | 47.9 | 46.5 | 37.2 | 33.8 |
| Bolivia 3/ | 44.1 | 48.0 | 34.0 | 31.5 | 30.7 |
| Brazil | 36.2 | 41.0 | 35.4 | 32.8 | 30.7 |
| Chile | 48.0 | 43.9 | 41.0 | 37.1 | 33.4 |
| Colombia | 25.0 | 24.0 | 22.0 | 20.0 | 19.0 |
| Ecuador | 28.0 | 26.8 | 26.0 | 25.0 | 22.0 |
| Ivory Coast | 18.4 | 17.4 | 17.9 | 17.3 | 15.6 |
| Mexico 4/ | 36.5 | 34.1 | 31.8 | 25.9 | 23.7 |
| Morocco | 20.9 | 29.9 | 31.5 | 28.2 | 26.9 |
| Nigeria | 10.7 | 14.0 | 25.9 5/ | 17.2 | 17.0 |
| Peru 6/ | 34.3 | 33.8 | 30.1 | 30.8 | 26.6 |
| Philippines 7/ | 28.3 | 25.8 | 28.1 | 26.2 | 24.1 |
| Uruguay | 31.4 | 32.9 | 31.5 | 28.1 | 25.2 |
| Venezuela | 25.8 | 22.2 | 20.8 | 19.6 | 18.4 |
| Yugoslavia | 40.0 | 44.4 | 44.2 | 36.0 | 32.0 |
| Pro memoria | | | | | |
| China | 1.4 | 1.6 | 1.8 | 2.5 | 3.1 |
| Jamaica | 18.2 | 22.6 | 24.6 | 23.3 | 22.2 |
| Korea | 11.2 | 11.5 | 10.4 | 10.0 | 8.4 |
| Portugal | 14.6 | 17.4 | 15.1 | 14.6 | 14.3 |

Sources: Staff estimates; and recent Board papers.

1/ Interest due after debt relief, including interest arrears accumulated during the year and interest on projected new borrowing.

2/ Outstanding interest arrears increased by the equivalent of 2.4 percent of exports in 1984 and are projected to decline by the equivalent of 16.6 percent in 1985.

3/ Outstanding interest arrears increased by the equivalent of 9.2 percent of exports in 1984 and by the equivalent of 26.2 percent of exports in 1985.

4/ Interest as a percentage of exports of goods and total service credits.

5/ The increase in the ratio of interest to exports in 1986 reflects principally interest due on notes issued in 1985 in payment of trade arrears.

6/ Estimates of the increase in interest arrears in 1984 and 1985 are presently not available.

7/ Interest arrears increased by the equivalent of 2.2 percent of exports in 1984 and are projected to decrease by the equivalent of 3.8 percent of exports in 1985.

**INTERNATIONAL MONETARY FUND**

Mr. Finch

These are the background notes requested by Mr Tenb & Mr. Brown, who have copies. They are in a very preliminary state, & not circulated to those at the 11 a.m. meeting.

C. Maxwell Watson

[illegible] 10/21

October 21, 1985

Options for Bank Debt Management: Categories of Debtor Countries

I. Countries that are borrowing on a market basis

1. Banks lending highly competitively [China]

2. Banks lending, given policy assurances (e.g., Fund programs) [Portugal]

3. Some key national groups of banks withdrawing [Korea]

II. Countries experiencing financial difficulties but for which the "new money" route is viewed as appropriate

1. Not yet fully in the market, but with needs small enough or outlook promising enough to do club deals [Ecuador]

2. Potentially returning to the market, but with needs so large (or remaining problems so visible) that club deals among friendly banks may not yet be possible [Mexico]

3. Doubts whether access to markets can be restored in foreseeable future [Chile]

III. Countries facing a very serious payments outlook

1. New medium term financing from banks not sought [Jamaica]

2. Protracted failure to implement rescheduling; net financing needs so large as to suggest eventual write-offs [Peru]

External Assets of Banks of Selected Industrial Countries vis-a-vis Selected Developing Countries at End-1984 1/

| | Argentina | Brazil | Mexico | Vene-zuela | Indonesia | Korea | Philip-pines | Major Borrowers | All Developing Countries 2/ | Capital Importing Developing Countries 2/ | Western Hemisphere 2/ |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | (In billions of U.S. dollars) | | | | | | |
| BIS reporting area 3/ | 25.1 | 65.5 | 70.7 | 26.3 | 12.9 | 25.9 | 12.4 | 238.8 | 447.6 | 424.0 | 225.4 |
| United States | 8.0 | 23.9 | 26.5 | 10.8 | 3.4 | 10.0 | 5.5 | 88.1 | 144.4 | 139.3 | 87.2 |
| United Kingdom 4/ | 3.4 | 9.3 | 8.7 | 2.8 | 1.5 | 2.8 | 1.7 | 30.2 | 63.1 | 59.4 | 30.0 |
| Germany | 2.4 | 4.8 | 3.5 | 1.9 | 1.9 | 1.0 | 0.5 | 16.0 | 38.4 13/ | 36.4 | 14.3 7/ |
| Canada | 0.8 | 6.0 | 5.8 | 1.4 | n.a. | n.a. | 0.9 5/ | n.a. | 17.2 8/ | n.a. | 8.7 13/ |
| Belgium | n.a. | 1.0 6/ | 1.2 6/ | n.a. | n.a. | n.a. | 0.2 5/ | n.a. | 6.4 6/9/ | n.a | 3.8 10/ |
| Switzerland | 1.2 | 1.6 | 2.0 | 0.8 | n.a. | n.a. | 0.1 5/ | n.a. | 18.4 11/ | n.a. | 6.5 |
| The Netherlands | 1.0 | 0.6 | 0.7 | 0.3 | n.a. | n.a. | n.a. | n.a. | 11.1 6/12/ | n.a | 2.8 |
| Luxembourg 6/ | 0.7 | 0.2 | 0.2 | 0.5 | n.a. | n.a. | n.a. | n.a. | 26.0 6/12/ | n.a | 7.6 |
| Japan | 2.5 | 11.0 | 13.1 | 3.2 | n.a. | n.a. | 3.2 5/ | n.a. | n.a. | n.a | n.a |
| France | 1.5 | 6.0 | 5.6 | 1.6 | n.a. | n.a. | 5.0 5/ | n.a. | n.a. | n.a. | n.a. |
| Italy | 0.4 | 0.3 | 1.6 | 0.4 | n.a. | n.a. | 0.5 5/ | n.a. | n.a. | n.a. | n.a. |
| Unallocated | 3.2 | 0.8 | 1.8 | 2.6 | 6.1 | 12.1 | [-0.8] 5/ | 104.5 | 122.6 | 188.9 | 64.5 |
| | | | | | (In percent of BIS Reporting Area Claims) | | | | | | |
| United States | 31.9 | 36.5 | 37.5 | 41.1 | 26.4 | 38.6 | 44.4 | 36.9 | 32.3 | 32.9 | 38.7 |
| United Kingdom | 13.6 | 14.2 | 12.3 | 10.7 | 11.6 | 10.8 | 13.7 | 12.7 | 14.1 | 14.0 | 13.3 |
| Germany | 9.6 | 7.3 | 5.0 | 7.2 | 14.7 | 3.9 | 4.0 | 6.7 | 8.6 | 8.6 | 6.3 |
| Canada | 3.2 | 9.2 | 8.2 | 5.3 | n.a. | n.a. | 7.2 | n.a. | 3.8. | n.a. | 3.9 |
| Belgium | n.a. | 1.5 | 1.7 | n.a. | n.a. | n.a. | 1.6 | n.a. | 1.4 | n.a. | 1.7 |
| Switzerland | 4.8 | 2.4 | 2.8 | 3.0 | n.a. | n.a. | 0.8 | n.a. | 4.1 | n.a. | 2.9 |
| The Netherlands | 4.1 | 0.9 | 1.0 | 1.1 | n.a. | n.a. | n.a. | n.a. | 2.5 | n.a. | 1.2 |
| Luxembourg | 2.8 | 0.3 | 0.3 | 1.9 | n.a. | n.a. | n.a. | n.a. | 5.8 | n.a. | 3.4 |
| Japan | 10.0 | 16.8 | 18.5 | 12.2 | n.a. | n.a. | 25.8 | n.a. | n.a. | n.a. | n.a. |
| France | 6.0 | 9.2 | 2.3 | 1.5 | n.a. | n.a. | 0.8 | n.a. | n.a. | n.a. | n.a. |
| Italy | 1.6 | 0.5 | 2.3 | 1.5 | n.a. | n.a. | 0.8 | n.a. | n.a. | n.a. | n.a. |
| Unallocated | 12.7 | 1.2 | 2.5 | 9.9 | 47.3 | 46.7 | [-6.3] 5/ | 43.7 | 27.4 | 44.6 | 28.6 |

Sources: BIS, The Maturity Distribution of International Bank Lending; national publications, and staff estimates.

1/ Consolidated bank claims by country of ownership of banks, unless otherwise stated.

2/ Excluding offshore centers.

3/ The BIS data consist of two elements. First, the consolidated claims of banks with head offices in the G-10 countries plus Switzerland, Austri Denmark, Ireland, and Luxembourg (the reporting area) on countries outside the reporting area. Claims are defined as cross-border claims plus local claims in foreign currencies of affiliates in outside reporting area countries. Second, the cross-border claims on borrowers outside the reporting area of reporting area banks whose head offices are outside the reporting area.

4/ Consolidated claims of all banks registered in the United Kingdom. Some claims may also be included in other countries' consolidated figures where these countries have a majority ownership in U.K. registered banks

5/ Includes suppliers credits which are not separately identified.

6/ Territorial (not consolidated) reporting. Data for Luxembourg include subsidiaries of major foreign banks and are therefore overstated.

7/ Eight major borrowers in Latin America.

8/ Foreign currency assets booked in Canada of chartered banks on the world, excluding OECD countries.

9/ Excluding Europe, including offshore centers.

10/ Including offshore centers.

11/ At end-1983; excluding Hungary, Romania, including Ireland, Iceland, Hong Kong.

12/ Countries outside the BIS reporting area.

13/ Rough estimate.

tbakrtb2 (TBL)
October 21, 1985

External Assets of Banks of Selected Industrial Countries vis-à-vis Certain Market Borrowing Developing Countries that have Recently Encountered Payments Strains at end-1984 1/

| | Argentina | Bolivia | Brazil | Chile | Colombia | Ecuador | Ivory Coast | Mexico | Morocco | Nigeria | Peru | Philip-pines | Uruguay | Venezuela | Yugoslavia | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | | (In billions of U.S. dollars) | | | | | | | | |
| BIS reporting area 2/ | 25.1 | 0.7 | 65.5 | 13.1 | 6.5 | 4.6 | 2.7 | 70.7 | 3.9 | 8.8 | 4.7 | 12.4 | 2.0 | 26.3 | 9.2 | 256.2 |
| United States | 8.0 | 0.2 | 23.9 | 6.7 | 3.0 | 2.1 | 0.5 | 26.5 | 0.9 | 1.5 | 2.4 | 5.5 | 1.1 | 10.8 | 2.4 | 95.5 |
| United Kingdom 3/ | 3.4 | 0.1 | 9.3 | 2.1 | 0.8 | 0.7 | 0.3 | 8.7 | 0.4 | 2.4 | 0.7 | 1.7 | 0.4 | 2.8 | 1.7 | 35.5 |
| Germany | 2.4 | 0.1 4/ | 4.8 | 0.8 | 0.3 | 0.3 | 0.3 4/ | 3.5 | 0.5 | 1.5 | 0.3 | 0.5 | 0.1 4/ | 1.9 | 1.6 | 18.9 |
| Canada | 0.8 | n.a. | 6.0 | n.a. | n.a. | n.a. | n.a. | 5.8 | n.a. | n.a. | n.a. | 0.9 5/ | n.a. | 1.4 | n.a. | n.a |
| Belgium | n.a. | n.a. | 1.0 6/ | n.a. | n.a. | n.a. | n.a. | 1.2 6/ | n.a. | n.a. | n.a. | 0.2 5/ | n.a. | n.a. | n.a. | n.a |
| Switzerland | 1.2 | n.a. | 1.6 | n.a. | n.a. | n.a. | n.a. | 2.0 | n.a. | n.a. | n.a. | 0.1 5/ | n.a. | 0.8 | n.a. | n.a |
| The Netherlands | 1.0 | n.a. | 0.6 | n.a. | n.a. | n.a. | n.a. | 0.7 | n.a. | n.a. | n.a. | n.a. | n.a. | 0.3 | n.a. | n.a |
| Luxembourg 6/ | 0.7 | n.a. | 0.2 | n.a. | n.a. | n.a. | n.a. | 0.2 | n.a. | n.a. | n.a. | n.a. | n.a. | 0.5 | n.a. | n.a |
| Japan | 2.5 | n.a. | 11.0 | n.a. | n.a. | n.a. | n.a. | 13.1 | n.a. | n.a. | n.a. | 3.2 5/ | n.a | 3.2 | n.a. | n.a |
| France | 1.5 | n.a. | 6.0 | n.a. | n.a. | n.a. | n.a. | 5.6 | n.a. | n.a. | n.a. | 5.0 5/ | n.a. | 1.6 | n.a. | n.a |
| Italy | 0.4 | n.a. | 0.3 | n.a. | n.a. | n.a. | n.a. | 1.6 | n.a. | n.a. | n.a. | 0.5 5/ | n.a. | 0.4 | n.a. | n.a |
| Unallocated | 3.2 | 0.3 | 0.8 | 3.5 | 2.4 | 1.5 | 1.6 | 1.8 | 2.1 | 3.4 | 1.3 | [-0.8] 5/ | 0.4 | 2.6 | 3.5 | 106.3 |
| | | | | | | | | (In percent of BIS Reporting Area Claims) | | | | | | | | |
| United States | 31.9 | 28.6 | 36.5 | 51.1 | 46.2 | 45.7 | 18.5 | 37.5 | 23.1 | 17.0 | 51.1 | 44.4 | 55.0 | 41.1 | 26.1 | 37.3 |
| United Kingdom | 13.6 | 14.3 | 14.2 | 16.0 | 12.3 | 15.2 | 11.1 | 12.3 | 10.3 | 27.3 | 14.9 | 13.7 | 20.0 | 10.7 | 18.5 | 13.9 |
| Germany | 9.6 | 14.3 | 7.3 | 6.1 | 4.6 | 6.5 | 11.1 | 5.0 | 12.8 | 17.0 | 6.4 | 4.0 | 5.0 | 7.2 | 17.4 | 7.4 |
| Canada | 3.2 | n.a. | 9.2 | n.a. | n.a. | n.a. | n.a. | 8.2 | n.a. | n.a. | n.a. | 7.2 | n.a. | 5.3 | n.a. | n.a |
| Belgium | n.a. | n.a. | 1.5 | n.a. | n.a. | n.a. | n.a. | 1.7 | n.a. | n.a. | n.a. | 1.6 | n.a. | n.a. | n.a. | n.a |
| Switzerland | 4.8 | n.a. | 2.4 | n.a. | n.a. | n.a. | n.a. | 2.8 | n.a. | n.a. | n.a. | 0.8 | n.a. | 3.0 | n.a | n.a |
| The Netherlands | 4.1 | n.a. | 0.9 | n.a. | n.a. | n.a. | n.a. | 1.0 | n.a. | n.a. | n.a. | n.a. | n.a. | 1.1 | n.a. | n.a |
| Luxembourg | 2.8 | n.a. | 0.3 | n.a. | n.a. | n.a. | n.a. | 0.3 | n.a. | n.a. | n.a. | n.a. | n.a. | 1.9 | n.a. | n.a |
| Japan | 10.0 | n.a. | 16.8 | n.a. | n.a. | n.a. | n.a. | 18.5 | n.a. | n.a. | n.a. | 25.8 | n.a. | 12.2 | n.a. | n.a |
| France | 6.0 | n.a. | 9.2 | n.a. | n.a. | n.a. | n.a. | 2.3 | n.a. | n.a. | n.a. | 0.8 | n.a. | 1.5 | n.a. | n.a |
| Italy | 1.6 | n.a. | 0.5 | n.a. | n.a. | n.a. | n.a. | 2.3 | n.a. | n.a. | n.a. | 0.8 | n.a. | 1.5 | n.a. | n.a |
| Unallocated | 12.7 | 42.9 | 1.2 | 26.7 | 36.9 | 32.6 | 59.3 | 2.5 | 53.8 | 38.6 | 27.7 | [-6.3] 5/ | 20.0 | 9.9 | 38.0 | 41.5 |
| | | | | | | (Percentage of external assets with residual maturity of 1 year of less) | | | | | | | | | | |
| BIS reporting area | 54.9 | 61.9 | 25.1 | 28.1 | 39.4 | 36.1 | 23.9 | 24.0 | 31.6 | 29.1 | 43.5 | 53.1 | 28.9 | 65.2 | 27.6 | 34.7 |
| United States | 67.0 | 77.8 | 36.5 | 33.1 | 58.4 | 50.0 | 37.7 | 29.2 | 69.3 | 46.1 | 55.8 | 65.5 | 32.5 | 79.7 | 33.4 | 45.2 |
| United Kingdom | 50.6 | 64.5 | 21.2 | 25.9 | 37.5 | 33.7 | 24.6 | 26.9 | 38.0 | 34.5 | 36.7 | 53.6 | 26.3 | 62.5 | 28.2 | 33.1 |

Sources: BIS, The Maturity Distribution of International Bank Lending; national publications, and staff estimates.

1/ Consolidated bank claims by country of ownership of banks, unless otherwise stated.

2/ The BIS data consist of two elements. First, the consolidated claims of banks with head offices in the G-10 countries plus Switzerland, Austria, Denmark, Ireland, and Luxembourg (the reporting area) on countries outside the reporting area. Claims are defined as cross-border claims plus local claims in foreign currencies of affiliates in outside reporting area countries Second, the cross-border claims on borrowers outside the reporting area of reporting area banks whose head offices are outside the reporting area.

3/ Consolidated claims of all banks registered in the United Kingdom. Some claims may also be included in other countries' consolidated figures where these countries have a majority ownership in U.K. registered banks

4/ Rough estimate.

5/ Includes suppliers credits which are not separately identified.

6/ Territorial (not consolidated) reporting. Data for Luxembourg include subsidiaries of major foreign banks and are therefore overstated.

tbakrtb3 (TBL)
October 21, 1985

Table . Interest Payments as Percentage of Exports of Goods and Nonfactor Services in Selected Countries, 1984-88

(In percent)

| | 1984 | 1985 | 1986 | 1987 | 1988 |
|---|---|---|---|---|---|
| Argentina | 56.2 | 52.1 | 46.5 | 37.2 | 33.8 |
| Bolivia | 40.1 1/ | 36.2 1/ | 30.6 | 28.2 | 26.8 |
| Brazil | 36.2 | 41.0 | 35.4 | 32.8 | 30.7 |
| Chile | 48.0 | 43.9 | 41.0 | 37.1 | 33.4 |
| Colombia | 25.0 | 24.0 | 22.0 | 20.0 | 19.0 |
| Ecuador | 28.0 | 26.8 | 26.0 | 25.0 | 22.0 |
| Ivory Coast | 18.4 | 17.4 | 17.9 | 17.3 | 15.6 |
| Mexico 2/ | 36.8 | 22.6 | 19.6 | 19.0 | 17.2 |
| Morocco | 19.4 | 33.3 | 31.5 | 28.2 | 26.9 |
| Nigeria | 10.7 | 14.0 | 25.9 | 17.2 | 17.0 |
| Peru | | | | | |
| Philippines | 26.1 | 31.7 | 28.1 | 26.2 | 24.1 |
| Uruguay | 32.4 | 32.0 | 31.5 | 28.1 | 25.2 |
| Venezuela | 25.8 | 22.2 | 20.8 | 19.6 | 18.4 |
| Yugoslavia | 40.0 | 44.4 | 44.2 | 36.0 | 32.0 |
| Pro memoria | | | | | |
| China | 1.4 | 1.6 | 1.8 | 2.5 | 3.1 |
| Jamaica | 19.6 | 23.6 | 24.6 | 23.3 | 22.2 |
| Korea | 11.2 | 11.5 | 10.4 | 10.0 | 8.4 |
| Portugal | 14.6 | 17.4 | 15.1 | 14.6 | 14.3 |

Sources: Staff estimates; and recent Board papers.

1/ Scheduled interest payments, including interest arrears.
2/ Public sector debt only.

# Office Memorandum

cc: Mr. Neuhaus



To: The Deputy Managing Director — October 23, 1985

From: David Williams DW

Subject: Repurchases by Selected Members

As you requested, I attach a table showing repurchases by selected members over the forthcoming decade. As we agreed, the repurchase schedules have been calculated on the basis of outstanding balances and we have made no estimate for repurchases with respect to further drawings under stand-by and extended arrangements presently in effect. We have, of course, also assumed that the members' quotas will remain unchanged through the period. I was not sure whether you mentioned Morocco to me, but I have, in case you need it, added the data for Morocco as well as for the seventeen other countries.

Attachment

cc: The Managing Director
Mr. Habermeier (on return)
Mr. Brown
Mr. Collins

Repurchases by Selected Membe

(In millions of SDRs)

| | | | Repurchase 10/1/85 - 12/31/85 | Amounts to be Repurchased - Calendar Years | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | 1986 | 1987 | 1988 | 1999 | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 |
| Argentina | Amount | 2,105.110 | — | 337.262 | 494.376 | 381.891 | 469.491 | 259.496 | 88.688 | 73.906 | — | — | — |
| | Percent of Quota | 189.1 | — | 30.3 | 44.4 | 34.3 | 42.2 | 23.3 | 8.0 | 6.6 | — | — | — |
| Bolivia | Amount | 50.729 | 4.014 | 25.332 | 19.146 | 2.238 | — | — | — | — | — | — | — |
| | Percent of Quota | 55.9 | 4.4 | 27.9 | 21.1 | 2.5 | — | — | — | — | — | — | — |
| Brazil | Amount | 4,205.400 | — | 525.539 | 876.975 | 691.367 | 633.459 | 563.680 | 368.875 | 228.594 | 223.391 | 93.521 | — |
| | Percent of Quota | 287.8 | — | 36.0 | 60.0 | 47.3 | 43.3 | 38.6 | 25.2 | 15.6 | 15.3 | 6.4 | — |
| Chile | Amount | 928.100 | — | 152.346 | 280.871 | 199.808 | 139.492 | 93.667 | 33.271 | 13.021 | 5.208 | 5.208 | 5.208 |
| | Percent of Quota | 210.7 | — | 34.6 | 63.8 | 45.4 | 31.7 | 21.3 | 7.6 | 3.0 | 1.2 | 1.2 | 1.2 |
| Ecuador | Amount | 264.000 | — | 5.518 | 90.204 | 102.265 | 34.237 | 22,898 | 7.559 | 1.319 | — | — | — |
| | Percent of Quota | 175.2 | — | 3.7 | 60.0 | 67.9 | 22.7 | 15.2 | 5.0 | 0.9 | — | — | — |
| Ivory Coast | Amount | 575.725 | 22.978 | 107.205 | 102.739 | 127.566 | 109.502 | 63.797 | 28.056 | 12.754 | 1.128 | — | — |
| | Percent of Quota | 347.9 | 13.9 | 64.8 | 62.1 | 77.1 | 66.2 | 38.5 | 17.0 | 7.7 | 0.7 | — | — |
| Mexico | Amount | 2,703.305 | — | 125.391 | 280.039 | 418.999 | 530.373 | 506.967 | 369.038 | 221.718 | 170.531 | 78.578 | 1.672 |
| | Percent of Quota | 231.9 | — | 10.8 | 24.0 | 36.0 | 45.5 | 43.5 | 31.7 | 19.0 | 14.6 | 6.7 | 0.1 |
| Philippines | Amount | 782.508 | 36.771 | 224.998 | 243.254 | 119.673 | 71.625 | 43.750 | 29.188 | 13.250 | — | — | — |
| | Percent of Quota | 177.7 | 8.3 | 51.1 | 55.2 | 27.2 | 16.3 | 9.9 | 6.6 | 3.0 | — | — | — |
| Uruguay | Amount | 226.800 | 9.450 | 48.181 | 81.542 | 46.928 | 22.408 | 18.291 | — | — | — | — | — |
| | Percent of Quota | 138.5 | 5.8 | 29.4 | 49.8 | 28.6 | 13.7 | 11.2 | — | — | — | — | — |
| Yugoslavia | Amount | 1,942.166 | 90.945 | 362.497 | 385.758 | 454.220 | 396.652 | 183.969 | 52.188 | 15.938 | — | — | — |
| | Percent of Quota | 316.8 | 14.8 | 59.1 | 62.9 | 74.1 | 64.7 | 30.0 | 8.5 | 2.6 | — | — | — |
| Hungary | Amount | 972.000 | 88.300 1/ | 40.971 | 272.852 | 263.929 | 174.190 | 92.800 | 38.958 | — | — | — | — |
| | Percent of Quota | 183.2 | 16.6 | 7.7 | 51.4 | 49.7 | 32.8 | 17.5 | 7.3 | — | — | — | — |
| Korea | Amount | 1,448.531 | 75.500 | 226.781 | 291.914 | 369.592 | 233.868 | 158.943 | 79.944 | 11.991 | — | — | — |
| | Percent of Quota | 313.0 | 16.3 | 49.0 | 63.1 | 79.9 | 50.5 | 34.3 | 17.3 | 2.6 | — | — | — |
| Indonesia | Amount | 116.162 | 74.200 2/ | — | — | 41.962 | — | — | — | — | — | — | — |
| | Percent of Quota | 11.5 | 7.3 | — | — | 4.2 | — | — | — | — | — | — | — |
| Malaysia | Amount | 179.911 | 72.700 3/ | 23.286 | 69.800 | 14.125 | — | — | — | — | — | — | — |
| | Percent of Quota | 32.7 | 13.2 | 4.2 | 12.7 | 2.6 | — | — | — | — | — | — | — |
| Romania | Amount | 815.452 | 32.603 | 199.318 | 225.980 | 158.714 | 128.074 | 53.443 | 17.319 | — | — | — | — |
| | Percent of Quota | 155.8 | 6.2 | 38.1 | 43.2 | 30.3 | 24.5 | 10.2 | 3.3 | — | — | — | — |
| Thailand | Amount | 937.967 | 59.216 | 230.845 | 162.528 | 171.119 | 177.291 | 111.968 | 12.500 | 12.500 | — | — | — |
| | Percent of Quota | 242.6 | 15.3 | 59.7 | 42.0 | 44.3 | 45.9 | 29.0 | 3.2 | 3.2 | — | — | — |
| Turkey | Amount | 1,268.030 | 60.516 | 320.322 | 344.223 | 320.938 | 185.781 | 36.250 | — | — | — | — | — |
| | Percent of Quota | 295.5 | 14.1 | 74.6 | 80.2 | 74.8 | 43.3 | 8.4 | — | — | — | — | — |
| | Total Amounts | 19,521.896 | 627.193 | 2.955.792 | 4,222.201 | 3,885.334 | 3,306.443 | 2,209.919 | 1,125.584 | 604.991 | 400.258 | 177.307 | 6.880 |
| Morocco | Amount | 1,150.083 | 66.806 | 274.177 | 243.904 | 169.148 | 193.341 | 137.960 | 52.245 | 12.500 | — | — | — |
| | Percent of Quota | 375.1 | 21.8 | 89.4 | 79.6 | 55.2 | 63.1 | 45.0 | 17.0 | 4.1 | | | |
| | Total Amounts | 20,671.979 | 693.999 | 3,229.969 | 4,466.105 | 4,054.482 | 3,499.784 | 2,347.879 | 1,177.829 | 617.491 | 400.258 | 177.307 | 6.880 |

1/ Includes early repurchase of SDR 88.0 million expected to be made before end-December 1985.
2/ Includes early repurchase of SDR 74.2 million expected to be made before end-November 1985.
3/ Includes early repurchase of SDR 72.7 million expected to be made before end-November 1985.

OFFICE OF THE
MANAGING DIRECTOR

INTERNATIONAL MONETARY FUND
WASHINGTON, D. C. 20431

CABLE ADDRESS
INTERFUND

October 21, 1985

TO: Mr. Erb
Mr. Finch
Mr. Hood
Mr. Mohammed
Mr. Van Houtven
Mr. Caiola
Mr. Rose
Mr. Watson
Mr. Williams

FROM: Robert M.G. Brown RMG Brown

SUBJECT: Debt problems

I attach a memorandum prepared by the Managing Director which will be discussed at a meeting to be held on Tuesday, October 22, at 11:00 a.m., in the Managing Director's Conference Room.

Attachment

cc: Mr. Habermeier o/r
Mr. Wiesner o/r
Mr. Whittome o/r
Mr. Beza o/r

RECEIVED
OCT 22 1985
EXCHANGE & TRADE RELATIONS

# THOUGHTS ON HOW COMMERCIAL BANKS CAN BE INVOLVED IN SOLVING THE FINANCING PROBLEMS OF INDEBTED COUNTRIES

## I. General Considerations

1. The bank withdrawal phenomenon

No one contests the scope and relative severity of this phenomenon. The available statistics for 1985 show that the net contribution of banks to the indebted countries' financing has virtually stopped. Not one of the bankers with whom I spoke in Europe views this phenomenon as "normal" or compatible with an orderly solution to the debt problem. To quote one of my interlocuteurs, "It would be desirable for the recent disengagement to be followed by a moderate net contribution by the banks."

2. The banks' reaction to the problem

(a) The general concept put forward by Mr. Baker is not challenged. Everyone with whom I spoke agrees that:

-- The case-by-case approach must be continued (while by contrast there is strong opposition to a global approach, in which the same formulas would be applied to every country);

-- this strategy must be supported by an appropriate combination of adjustment measures (preferably negotiated and monitored by the IMF) and financing;

-- multilateral agencies must be involved in the financing (a larger role for the World Bank and the regional development banks is looked on with special favor), as must governments (bankers remain disappointed and suspicious about governments' role in guaranteeing export credits to certain Latin American countries) and commercial banks;

-- the general idea of adjustment that is oriented toward restoring conditions leading to steadier growth in the debtor countries is of course widely supported.

(b) The banks are showing a wait-and-see posture, and at the same time are worried.

-- A wait-and-see posture: Few of the bankers I met are proposing precise ideas or formulas. They recognize the need to act, but do not yet seem to have developed a position at this stage.

-- The banks' worries: Several bankers told me they are not sure how real the commitment of the industrial countries to support the World Bank financially is ("we will believe it when we see the Bank get a general capital increase," one of them said to me). They are not very happy with governments' timidity in the area of export credits to certain countries or of multi-year rescheduling. Nor do they know how the World Bank will be involved in the process, and they are afraid that the matter of a replacement for the Bank's President will delay the initiation of the IBRD part of the arrangment.

(c) The concept of equal burden sharing remains deeply rooted. In France, Japan and the United Kingdom there is a real fear of a binding arrangement from which small banks might be exempted. The attitude of the American regional banks gives rise to concern and even suspicion in this regard. In France, especially, there is a strong fear that the major banks, or those that go along with the plan (meaning in fact <u>all</u> French banks) will be "penalized" by the nonparticipation of certain foreign banks. This fear can be allayed only if the arrangement:

-- ensures that all banks will participate; or, if not,

-- distributes the burden country by country, with each country's leading banks taking care of the national quota (based on the outstanding debt country by country).

(d) The difference in attitudes is due in part to differences in the way provision has been made for the risks.

The German and Swiss banks appear to be rather well provisioned. They will look closely at any new commitment (which they will also have to provide against if the regulations do not change). The German authorities, who have granted large tax advantages for provisioning, will bear this consideration in mind when they are asked to influence the German banks on amounts of new commitments. Naturally, these banks will tend to be more concerned with the amounts than with the terms.

French banks appear to be less well provisioned and are widely known to be undercapitalized, although the concept loses some of its relevance in view of the fact that the entire apparatus of French banking has been nationalized. They will go along, but will hesitate to make sacrifices with regard to terms because their domestic earnings have been discouraging (I was told at the French Treasury that a cut of 2-1/2 percentage points in the interest received from the developing countries alone would entirely wipe out the annual profits of the French banks.)

Given the highly centralized structure of Japanese banking, the banks there will go along, but they will be particularly concerned with making sure that the principle of equal burden sharing is respected, as will the British banks. British bankers (merchant bankers being somewhat more open than the clearing banks) stress the importance of tangible participation by governments and by the World Bank.

Finally, seen from Europe, the U.S. banking system appears to be marked by:

-- excessive concern with their earnings reports (to the detriment of adequate provisioning);

-- a certain regulatory inconsistency, including an inconsistent approach to provisioning (the regulatory system offers too few tax incentives for provisioning, but at the same time regulators do not pay enough attention to the efforts at economic recovery undertaken by debtor countries when assessing the quality of risks; the lack of tax incentives makes highly exposed major banks turn to approaches based on new money, while the second factor causes small and medium-sized banks with little exposure in indebted countries to withdraw from the arrangement;

-- The apparent inability of the authorities to exert pressure on small and medium-sized banks to participate in cooperative efforts.

II. Possible outline of a solution

1. General Considerations

(a) The authorities must be very clear from the start about what they can and cannot do.

-- There must be hard evidence that support for an increase in World Bank financing is more than a pious wish.

-- Export credit insurance agencies must be much more closely involved in the financing process, and the follow-up must be organized and monitored.

-- The bank regulatory systems must be adapted and made to serve the strategy.

-- What the authorities cannot do must also be clear from the outset: there will be no official guarantees of bank financing under the strategy. Any possible misunderstandings on this subject should be dispelled.

(b) The principle of bank solidarity should be part of the arrangement, with the term being defined either as relating to the banks in one national area or as encompassing all the banks in the world.

2. Possible outline of a solution

We can imagine two types of solutions:

-- Those based on new money alone;

-- those based on a wider range of kinds of participation, so that participation can be as universal as possible.

A. Approaches based on new money alone.

This approach would hark back to that of 1982-84. Three-year financing needs would be established on the basis of programs or consultations with the Fund and in close liaison with the Bank. When it is known what official financing is available, particularly from the World Bank and other development agencies, negotiations with the banks would begin (advisory committees, merged into a single body if necessary). The "critical mass" concept would be retained. If some banks (regional or marginally concerned) refused to participate, the concept of "bank responsibility by nationality" would, as I see it, be demanded by the major European and Japanese banks. In other words, the group of participating banks (those that play the game) would not seem to be ready to "pay" in a non-geographically differentiatied way for the non-participation of other banks. To put it another way, the lead banks in the United States should take care of the defection of regional banks, etc. (perhaps by means of the exit bonds discussed below).

This approach has the advantage of simplicity, but the idea of bank responsibility split by nationality can entail some dangers:

-- it will induce the lead banks to demand guarantees for the extra exposure they would have to assume to make up for non-participating banks;

-- it could induce small and medium-sized banks to opt out, seriously eroding the level of participation;

-- it is virtually impossible to determine a criterion for identifying the precise point at which the "participating bank" concept begins.

B. Approaches involving diversified kinds of participation, enabling the largest possible number of banks to participate in the strategy

The idea would be to offer banks a number of options:

(a) The usual new money approach;

(b) partial capitalization of interest;

(c) for a portion of the contributions, offer a way out in the form of "exit bonds" issued by a group of major banks. These bonds would be issued at a discount determined by the state of the "market." In view of what was said above about "national solidarity," it may be anticipated that the large banks will subscribe these bonds in a manner which reflects the exact percentage of "exits", country by country.

(d) For all or part, new money could be in the form of securities representing claims on a "trust" (the trust itself could be established on a country-by-country, regional, or world-wide basis) that would provide financing for the structural or sectoral development of the country concerned under World Bank auspices. One might even envisage all the major banks (as well as the World Bank and development banks) contributing to the trust's capital. But it has to be acknowledged that this formula would not be just for recalcitrant banks. Even a limited guarantee from the World Bank would be so attractive that all banks will want to take this option.

(e) Opportunity for banks that are unwilling to contribute new money to purchase equity in enterprises of the country concerned. To facilitate the implementation of this formula, an equity financing vehicle could be set up on a regional or individual country basis with IFC assistance. New money would therefore take the form of participation in the equity of this entity.

Some of the above options could be offered in combination. All of them have both advantages and disadvantages.

(a) Is not new and has already been commented on.

(b) The capitalization idea is perhaps the one with the most disadvantages. It does not reduce the debt overhang and could tempt debtor countries to set the capitalization rate unilaterally some day.

(c) The "exit" could be a useful formula for releasing marginal banks. The disadvantage is that the discount could have an adverse effect on the confidence of the market and of regulators in assets still carried at par in the books of other banks. This formula could therefore be of only marginal use. The need to divide implementation of this formula geographically by bank area could also complicate things and cause the banks to request guarantees from their governments.

(d) I will not dwell on this item, which actually raises the more general problem of the link between bank loans and World Bank loans. This issue, with or without a separate entity, is of intense interest to the banks.

(e) The advantages of this formula should not be underestimated. It is the only one that avoids an expansion of the debt. Properly used, it could also lead to improved industrial management in the countries concerned, facilitate the privatization of public enterprises, etc. The IFC could play a crucial role.

Some small banks might prefer to implement (e) by converting existing claims rather than by putting in new money. I see no reason to object to their doing so.

In conclusion, I believe that:

1. The time has come for the United States to hold prompt discussions with its industrial partners (G5, G10). The administration should exercise strong leadership, but also consult its partners.
2. The banks must be put to work. They must understand the rules of the game, rid themselves of certain illusions, and be in a position to propose constructive, imaginative solutions.
3. The solutions must be simple and fair (as among countries and as among banks).
4. The danger of grandiose schemes and of overly ambitious organizational schemes must not be overlooked. There must be clear reasons for any new body that is created.

Confidential

Bank of America

Samuel H. Armacost
President

RECEIVED
OCT 29 1985
EXCHANGE & TRADE RELATIONS

October 18, 1985

The Honorable James Baker
Secretary of the Treasury
Washington, D.C. 20220

Dear Secretary Baker:

I am sorry I was unable to attend your initial meeting on international debt issues on October 1. Unfortunately, I already had left for Asia. Lee Prussia's attendance was vital in supplying us with your views and proposed plan of action.

We at Bank of America are very pleased and encouraged at your stepping forward and providing leadership on this critical issue. You will have our complete support in your efforts to provide new impetus to finding solutions to the debt problems of the developing countries. We all recognize that finance cannot be seen in isolation and that a resolution of the current financial difficulties is possible only if appropriate adjustment measures are taken by the debtor countries that result in a strengthening of their economic structure and increased economic growth. Therefore, we are pleased that your plan emphasizes fundamental structural reforms as an essential element to the restoration of the creditworthiness of those nations that are now encountering payment difficulties.

You asked us to share with you our ideas as to what reforms in the debtor countries are particularly appropriate and desirable. I am happy to do so.

The key to a rejuvenation of economic growth in the debtor countries lies in a reduction of state interference and the unquestioned support of private enterprise and initiative by the respective governments. Just adding more debt to an economy already unable to service the existing debt load will not lead to a resolution of the problems.

P. O. Box 37000 San Francisco, California 94137

Fundamental domestic economic reforms should include the elimination of price controls and governmental subsidies. Public and semi-public enterprises should be sold to the private sector. The resulting savings can be used to reduce the public sector deficits that take up a large proportion of investable funds in many debtor countries.

The financial sector of the various developing countries needs to be deregulated and reformed. Fiscal and monetary stability should be restored if private domestic savings are to increase. Incentives for domestic savers need to be enhanced and positive real interest rates should be encouraged. The local constraints on the operations of foreign banks need to be relaxed if they are to be full partners in the rejuvenation process. Such domestic financial reforms are particularly important in countries like Brazil, Chile, Mexico and the Philippines, where foreign credit accounts for over 70 percent of total credit.

In the international sector, realistic exchange rates need to be implemented. Barriers to trade in the form of tariffs, quotas and licensing requirements should be reduced to foster economic efficiency and to avoid a disallocation of scarce investment funds.

One issue raised in the recent negotiations is of great importance to us all: We have not found a device for insisting that debtor countries make more constructive efforts to open their borders to investment capital inflows. We must encourage borrowers to turn to the international equity market (i.e. private capital) as an alternative to demanding more debt at cheaper prices for longer terms.

At the present time, foreign direct investment accounts for only approximately 15 percent of the total external liabilities of the major debtor countries. To increase the incentives to foreign investors, the foreign direct investment codes in the debtor countries need to be revised or eliminated. The local ownership and domestic content requirement should be abolished. The ideal situation would be the equal, or "national," treatment of foreign and domestic investors. The Multilateral Investment Guarantee Agency should be given final approval.

We at Bank of America stand ready to make further funds available to those countries that take appropriate adjustment measures and thereby improve their external and domestic economic and financial performance. You will appreciate that it would be difficult to make additional lending commitments in countries that are being criticized by the bank examiners. You may also be aware of a tax proposal under consideration by the Ways and Means Committee which would restrict the creditability of taxes levied on bank loans to these same countries. This proposal, if enacted, would severely undermine the ability of commercial banks to participate in your strategy.

We also would like to be supportive of foreign direct investment efforts by American corporations in the key debtor countries. We therefore assume that credits granted in support of such foreign direct investments in the major debtor countries will be included in the calculation of the "fresh money" made available to these countries.

Speaking for Bank of America, and echoing the views of many peer banks, we find it increasingly offensive to be in essence financing capital flight. I am encouraging our people to find some effective trigger mechanisms which make the availability of further advances contingent upon success in stopping the flow of capital out of a country above some defined level. This issue cannot be enforced by commercial banks alone, but will require concerted efforts by government and multilateral lending institutions. It may be that in redefining "conditionality" the World Bank or the IMF can find more effective ways to insure that the capital stays where it is most needed.

In Seoul, I detected real unhappiness among foreign banks which feel that their banking systems have participated fully in the LDC debt solution, while participation from American banks is increasingly limited to the bigger institutions. This concerns us greatly too, and while we understand the "American Way," the big players find it objectionable that we are encouraged to take more risk, which provides less risk for other lenders who can then pursue other opportunities. We must find a more balanced system of rewards and penalties.

Mr. Secretary, we believe that the efforts by you and the governments of the Group of Five to bring about a greater coordination of the adjustment efforts of the debtor countries, the commercial banks, and the multilateral agencies are most desirable and important. However, we also believe that governmental agencies, such as the Export Import Bank of the United States and its sister institutions in the other countries, should be brought into this effort in a major way.

As I stated earlier, we are fully supportive of your efforts to provide leadership in the resolution of the important economic and financial problems facing all of us. We will do everything in our power to assist, provided all other interested parties fully participate in the program outlined by you.

Sincerely yours,

bcc: R. Frick
B. Heller
E. Martin
J. Stephan

Mr Finch

# *Office Memorandum*

TO: The Managing Director
The Deputy Managing Director

October 8, 1985

FROM: Charles Gardner

SUBJECT: Secretary Baker's Press Briefing

U.S. Treasury Secretary James Baker briefed the press at 8:45 this morning on his address this afternoon, outlining a three-point "integrated strategy" for consolidating progress in dealing with the debt problem, and achieving sustained growth.

He said his plan was needed because "strains are beginning to appear" in the present approach. However, he strongly endorsed continuation of the case-by-case method and emphasized repeatedly that his proposal was a "concept" for which the "modalities" remain to be worked out.

Key points:

(1) Debtor countries must adopt comprehensive macroeconomic and structural adjustment policies, promoting growth and adjustment, while reducing inflation.

(2) A continued, central role for the IMF is needed as the catalyst for new financial flows, complemented by more effective structural adjustment assistance from the multilateral development banks, in support of market-oriented strategies. The MDBs would be expected to raise disbursements to the fifteen largest debtor countries by 50 percent from the current annual level of $5.9 billion annually, or a cumulative increase of $9 billion over the three years 1986-88. These 15 countries are now slated to get $18 billion over the period, but would get $27 billion under Mr. Baker's plan.

(3) Increased lending by the commercial banks in support of adjustment programs. A cumulative net $20 billion increase over 1986-88 from the major banks worldwide is envisioned, a rise he put at 2.5 percent per year.

Commercial bank participation. Mr. Baker said he has sounded out the major U.S. banks on increasing their net exposures by $20 billion and their response was, "go ahead with it," but their participation depends on the actions of the debtors and the MDBs. The private banks cannot be expected to increase their exposure in the face of capital flight, and unless they see it in their own self-interest.

Role of the IMF. Asked if the debtors, and Brazil in particular, could participate in the plan without IMF programs, Mr. Baker said he proposes "expanding the role of the IBRD, not diminishing the role of the IMF," and that it would be in Brazil's best interest "to have an IMF agreement if it wants new private bank lending." Although the IMF "has been moving toward growth-oriented policies," countries cannot "get around some sacrifice." The IBRD is "perhaps better equipped to promote market-oriented policies, although the IMF has been doing that."

Banking regulation. In reply to an inquiry, he suggested that as his concept evolves, "there may well have to be a close look at what the regulatory authorities require."

Trust Fund and IMF/IBRD cooperation. Greater cooperation between the institutions would be "very salutary," but "they believe now that they should work more closely together."

"If our original proposal for the Trust Fund had been advanced, there would be even more cooperation. But some are not ready for such innovative ideas. There are problems in that (the Trust Fund proposal) so we may advance that later on," he said.

Role of IBRD and capital increase. If each of the three major participants in the strategy--debtors, multilateral development banks, commercial banks--does its part, and "we can bring all the pieces together, there will be a need for increased resources" for the World Bank; then, the U.S. would support a capital increase, but if it were to do so now, there would be "less incentive for the private banks."

The World Bank's role will be to provide more structural and sectoral adjustment loans, promote more cofinancing, and modify its 10 percent portfolio guideline. He denied that this approach, in the absence of a capital increse, would merely shift IBRD resources from one group of countries to another.

Mechanics. Despite his allusions to the major participants' "getting together," he does not envision a single forum of any kind. "The case-by-case approach must apply." Nor does he envision achieving comprehensive agreement on paper: what is needed is "clear public commitments by all major parties."

cc: Mr. Finch
Mr. Habermeier
Mr. Hood
Mr. Whittome
Mr. Mohammed
Mr. Nicoletopoulos
Mr. Wiesner/Mr. Beza
Mr. Collins/Mr. Brown

**BOARDS OF GOVERNORS • 1985 ANNUAL MEETINGS • SEOUL, REPUBLIC OF KOREA**

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
INTERNATIONAL FINANCE CORPORATION
INTERNATIONAL DEVELOPMENT ASSOCIATION
INTERNATIONAL MONETARY FUND

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Statement by the Hon. JAMES A. BAKER, III,
Secretary of the Treasury and Governor of the
Bank and Fund for the UNITED STATES,
at the Joint Annual Discussion

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It is a pleasure to be here for the Fortieth Annual Meetings of the International Monetary Fund and The World Bank. Strong, effective international financial institutions are as essential to our economic well-being today as they were 40 years ago.

Our host country, Korea, is a nation whose economic success is surpassed only by its warm hospitality. Korea's market-oriented approach and strong emphasis on private initiative are a lesson for us all.

## Foundation for Growth

I would like to focus my comments today on policies for growth within the context of the international debt strategy. Sound policies and sustained, low-inflation growth in the industrial countries must provide the essential foundation for a successful debt strategy, and are a prerequisite for stronger growth in the debtor countries.

The major industrial countries have already made considerable progress in this direction. Two weeks ago in New York the Finance Ministers and Central Bank Governors of the Group of Five industrial nations underscored the progress which had been achieved, particularly with regard to the convergence of economic performance toward sustained, low-inflation growth. They also announced a set of policy intentions that will help to consolidate and extend that progress and to improve and sustain growth for the longer term.

We emphasized, for our own countries, the central importance of reducing structural rigidities, strengthening incentives for the private sector, reducing the size of government, and improving the investment environment. We also rededicated our governments to resisting protectionist pressures that threaten our own prosperity and the opportunities for others. We must jointly accelerate our efforts to lanuch a new round of trade negotiations within the GATT.

These industrial nations agreed that the significant progress already achieved in promoting a better convergence of their economic performance had not been fully reflected in exchange markets and that some further orderly appreciation of the main non-dollar currencies against the dollar was desirable. We expressed our willingness to cooperate more closely to encourage this when to do so would be helpful.

This package of measures had an immediate, significant impact on exchange markets which continues to be positive, and reflects the importance of the commitments made.

I am convinced that if each of the major industrial nations fulfills its policy intentions and maintains or improves access to its markets, we will have taken a major step toward more balanced and sustainable growth, while providing a solid framework for improving the debt situation in the developing world.

<u>Strengthening the Debt Strategy</u>

Fellow Governors, it is essential that we begin the process of strengthening our international debt strategy.

Three years ago the international financial community developed a flexible, cooperative, case-by-case strategy to address the debt problem and lay the basis for growth in the debtor nations. In three years:

-- Aggregate current account deficits in developing countries have been sharply reduced from $104 billion in 1982 to $44 billion this year.

-- Growth in developing countries has been restored to about 4 percent, compared to less than 2 percent in 1982.

-- This growth has been fueled by sharp increases in developing nations' exports, including a 21 percent increase in their exports to the United States last year.

These developments reflect improved growth and sharply lower interest rates in the industrial nations, as well as adoption of improved policies within most debtor countries. These policies have been given important support by reschedulings and rollovers amounting to approximately $210 billion, and by net new commercial bank lending.

The international financial institutions have also played an important role in the progress that has been achieved. The IMF in particular has very capably played a leadership role, providing guidance on policies and temporary balance of payments financing, both of which have catalyzed commercial bank flows.

Despite this progress, some serious problems have developed. A number of principal debtor countries have recently experienced setbacks in their efforts to improve their economic situations, particulary with regard to inflation and fiscal imbalances, undercutting prospects for sustained growth. Bank lending to debtor nations has been declining, with very little net new lending anticipated this year. The sense of increasing reluctance among banks to participate in new money and debt rescheduling packages has introduced serious uncertainties for borrowers, in some cases making it more difficult for them to pursue economic reforms.

These problems need to be addressed, promptly and effectively, by building upon the international debt strategy in order to improve the prospects for growth in the debtor countries. This is an enterprise which will require, above all, that we work together and that we each strengthen our commitment to progress.

If the debt problem is to be solved, there must be a "Program for Sustained Growth," incorporating three essential and mutually reinforcing elements:

-- First and foremost, the adoption by principal debtor countries of comprehensive macroeconomic and structural policies, supported by the international financial institutions, to promote growth and balance of payments adjustment, and to reduce inflation.

-- Second, a continued central role for the IMF, in conjunction with increased and more effective structural adjustment lending by the multilateral development banks (MDBs), both in support of the adoption by principal debtors of market-oriented policies for growth.

-- Third, increased lending by the private banks in support of comprehensive economic adjustment programs.

I want to emphasize that the United States does not support a departure from the case-by-case debt strategy we adopted three years ago. This approach has served us well; we should continue to follow it. It recognizes the inescapable fact that the particular circumstances of each country are different. Its main components, fundamental adjustment measures within the debtor nations and conditionality in conjunction with lending, remain essential to the restoration of external balance and longer-term growth.

We need to build upon the current strategy to strengthen its ability to foster growth. There must be greater emphasis on both market-oriented economic policies to foster growth and adequate financing to support it.

In essence, what I am suggesting is that adequate financing can be made available through a combination of private creditors and multilateral institutions working cooperatively, but only where there are reasonable prospects that growth will occur. This will depend upon the adoption of proper economic policies by the developing countries. Financing can only be prudently made available when and as effective policies to promote economic efficiency, competitiveness, and productivity--the true foundations of growth--are put in place. We cannot afford to repeat the mistakes of the past. Adjustment must continue. Adjustment programs must be agreed before additional funds are made available, and should be implemented as those funds are disbursed.

These efforts should be mutually reinforcing. Sound policies in the principal debtor countries will not only promote growth, but will also stimulate the needed private bank lending. And it will be important that these policies be supported by the IMF, complemented by the MDBs. These institutions can help encourage and catalyze both needed policies and financing.

In today's highly interdependent world economy, efforts at economic isolationism are doomed to failure. Countries which are not prepared to undertake basic adjustments and work within the framework of the case-by-case debt strategy, cooperating with the international financial institutions, cannot expect to benefit from this three-point program. Additional lending will not occur. Efforts by any country to "go it alone" are likely to seriously damage its prospects for future growth.

I would like to elaborate on the actions that will be required by each participant in this three-point program.

Structural Change in the Principal Debtors

The essence of the need for structural change in the principal debtors is captured in two quotations I would like to share with you.

First:

> "The only way to overcome our economic crisis is to tackle at their root the structural problems of our economy to make it more efficient and productive." 1/

1/ President de la Madrid at the Mexican Bankers Association Annual Meeting, July 22, 1985.

And second:

> "Economic growth will have solid foundations only if we reestablish trust and stimulate private enterprise, which must be the flagship of our economic development....We will promote authentic institutional change in the economic sector." 1/

These are not the words of a U.S. Secretary of the Treasury. They are statements made in July of this year by the Presidents of Mexico and Brazil. I believe they reflect a growing sentiment in Latin America.

It is essential that the heavily indebted, middle-income developing countries do their part to implement and maintain sound policies. Indeed, without such policies, needed financing cannot be expected to materialize. Policy and financing are not substitutes but essential complements.

For those countries which have implemented measures to address the imbalances in their economies, a more comprehensive set of policies can now be put in place, which promises longer-term benefits from stronger growth, higher standards of living, lower inflation, and more flexible and productive economies. These must not only include macroeconomic policies, but also other medium- and longer-term supply-side policies to promote growth.

We believe that such institutional and structural policies should include:

-- increased reliance on the private sector, and less reliance on government, to help increase employment, production, and efficiency;

-- supply-side actions to mobilize domestic savings and facilitate efficient investment, both domestic and foreign, by means of tax reform, labor market reform, and development of financial markets; and

-- market-opening measures to encourage foreign direct investment and capital inflows, as well as to liberalize trade, including the reduction of export subsidies.

This broader approach does not mean that policy areas that have been the focus of efforts to date--in particular fiscal, monetary, and exchange rate policies--can receive less attention. Indeed, macroeconomic policies have been central to efforts to date and must be strengthened to achieve greater progress. These policies should consist of:

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1/ President Sarney in a televised address to the nation, July 23, 1985.

-- market-oriented exchange rate, interest rate, wage, and pricing policies to promote greater economic efficiency and responsiveness to growth and employment opportunities; and

-- sound monetary and fiscal policies focused on reducing domestic imbalances and inflation and on freeing up resources for the private sector.

The cornerstone of sustained growth must be greater domestic savings, and investment of those savings at home. Macroeconomic and structural policies which improve economic efficiency, mobilize domestic resources, and provide incentives to work, save, and invest domestically will create the favorable economic environment necessary for this to occur. Such an environment is also critical to attract supplemental foreign savings.

As a practical matter, it is unrealistic to call upon the support of voluntary lending from abroad, whether public or private, when domestic funds are moving in the other direction. Capital flight must be reversed if there is to be any real prospect of additional funding, whether debt or equity. If a country's own citizens have no confidence in its economic system, how can others?

There are essentially two kinds of capital inflows: loans and equity investments. Foreign borrowings have to be repaid--with interest. Equity investment, on the other hand, has a degree of permanence and is not debt-creating. Moreover, it can have a compounding effect on growth, bring innovation and technology, and help to keep capital at home.

We believe that the debtor nations must be willing to commit themselves to these policies for growth in order that the other elements of a strengthened debt strategy can come into place.

Enhanced Effectiveness of the International Financial Institutions

The international financial institutions must also play an important role in strengthening the debt strategy to promote growth. However, we must recognize that the international financial institutions cannot have sufficient resources to meet the debtor nations' financing needs all by themselves. An approach which assumes that the IMF and The World Bank are the sole answer to debt problems is simply a nonstarter. For most developing countries other sources must play a more important role. These include private sector borrowing, increased export earnings, foreign equity investment, and repatriation of capital which has fled abroad. All these routes should be pursued.

Among the international financial institutions, the IMF has played a major role in advising member nations on the development of policies necessary to promote adjustment and growth. There has been a particular focus on monetary, fiscal, and exchange rate policies, although increasing attention is being paid to other areas such as trade liberalization, pricing policies, and the efficiency of government-owned enterprises.

Emphasizing growth does not mean de-emphasizing the IMF. Through both its policy advice and balance of payments financing, the Fund has played a critical role in encouraging needed policy changes and catalyzing capital flows. It must continue to do so. But it must also develop new techniques for catalyzing financing in support of further progress. "Enhanced surveillance," for example, can sometimes provide an effective means of continued IMF involvement.

The Fund should give higher priority to tax reform, market-oriented pricing, the reduction of labor market rigidities, and to opening economies to foreign trade and investment. This will help assure that Fund-supported programs are growth-oriented. It will be particularly important for the Fund to work closely with The World Bank in this effort.

I would now like to turn more directly to the role of the MDBs, which need to be brought into the debt strategy in a stronger way, without diminishing the role still to be played by the IMF.

The World Bank, and indeed all MDBs, have considerable scope to build on current programs and resources, and to provide additional assistance to debtor nations which is disbursed more quickly and targeted more effectively to provide the needed stimulus to growth.

There is ample room to expand The World Bank's fast-disbursing lending to support growth-oriented policies, and institutional and sectoral reform. An increase in such lending can serve as a catalyst for commercial bank lending.

A serious effort to develop the programs of The World Bank and the Inter-American Development Bank (IDB) could increase their disbursements to principal debtors by roughly 50 percent from the current annual level of nearly $6 billion.

Increased disbursements would require greater borrowing by the MDBs in world capital markets. Their ability to borrow at low rates is a precious asset which must be preserved. Therefore, their lending must be in support of sound economic programs that enhance the borrower's ability to service its debt and grow.

It should be possible, with a concerted effort by both The World Bank and borrowers, to streamline World Bank operations in order to reduce considerably the time period required to formulate and implement such assistance programs. This will expedite the actual disbursement of funds.

The value and role of an indigenous, competitive private sector needs to be recognized and developed more fully than it has in the past. The Bank, for its part, should actively promote the development of the private sector and, where appropriate, provide direct assistance to this sector. In addition, the Bank should seek to assist, both in a technical and financial capacity, those countries which wish to "privatize" their state-owned enterprises, which in too many cases aggravate already serious budget deficit problems.

Given the importance of increasing commercial bank flows to the principal debtors, there is also an urgent need for efforts to expand the Bank's cofinancing operations. These efforts should be pursued vigorously to increase the effectiveness of the Bank in helping its borrowers to attract private finance, and should have substantial potential in the context of this three-point program.

The enhanced program of the International Finance Corporation, with an expanded capital base, and the recently negotiated Multilateral Investment Guarantee Agency (MIGA) are two important Bank Group initiatives in support of developing countries. Both organizations can do much to assist their members in attracting nondebt capital flows as well as critical technological and managerial resources. We urge all Bank members and particularly the principal debtors to give their full support to establishment of the MIGA.

If developing countries implement growth-oriented reform; if commercial banks provide adequate increases in net new lending to good performers; and if increased demand for quality IBRD lending demonstrates the need for increased capital resources, we would be prepared to look seriously at the timing and scope of a general capital increase.

We believe The World Bank's efforts can be supplemented actively by the regional development banks. Since some of the most serious debt problems are found in Latin America, special emphasis should be placed on strengthening the IDB's policies to enable it to be a more effective partner in support of growth-oriented structural reform.

In the case of an IDB capital increase, it will be critical to assess the extent to which the institution strengthens its lending policies. There must be well-defined economic and country strategies tailored to enhance economic reforms which encourage growth. Given a firm commitment by the IDB to move in this direction, we believe that it should be permitted to introduce a major program of well-targeted nonproject lending. In the meantime, such lending could be associated with World Bank programs until the IDB has implemented the necessary reforms.

Increasing Lending by the International Banking Community

The international banking community has played an important role during the past three years. I am, however, concerned about the decline in net bank lending to debtor nations over the past year and a half, particularly those nations which are making progress. All of us can appreciate the commercial bank's concerns, but we believe these concerns would dissipate if the banks were confident that new lending is in support of policies for growth in the developing nations.

If creditor governments, in an age of budget austerity, are to be called upon to support increases in multilateral development bank lending to the debtor nations, and if the recipient nations are asked to adopt sound economic policies for growth to avoid wasting that financing, then there must also be a commitment by the banking community --a commitment to help the global community make the necessary transition to stronger growth.

Our assessment of the commitment required by the banks to the entire group of heavily indebted, middle-income developing countries would be net new lending in the range of $20 billion for the next three years. In addition, it would be necessary that countries now receiving adequate financing from banks on a voluntary basis continue to do so, provided they maintain sound policies.

I would like to see the banking community make a pledge to provide these amounts of new lending and make it publicly, provided the debtor countries also make similar growth-oriented policy commitments as their part of the cooperative effort. Such financing could be used to meet both short-term financing and longer-term investment needs in the developing countries, and would be available, provided debtors took action and multilateral institutions also did their part.

We would welcome suggestions from the banking community about arrangements which could be developed in order to ensure that adequate financing to support growth is available.

## The Poorest Countries

Before concluding my statement, I would like to focus briefly on the problems of another set of debtor countries, the low-income debtors with protracted balance of payments problems. Special efforts are being made to assist these countries, but more can and should be done to improve their longer-term prospects.

The United States believes that the resources provided by the Trust Fund reflows provide a unique opportunity to help address the economic problems of the poorest countries with protracted balance of payments difficulties. Recent experience demonstrates that successful resolution of the economic problems of these countries requires a comprehensive approach, including fundamental structural policy changes, as well as sound macroeconomic policies.

The $2.7 billion in Trust Fund reflows present us with an opportunity to utilize IMF resources, possibly supplemented by funds from other sources, in support of such comprehensive economic programs. The effectiveness of such programs would be enhanced by close cooperation between the Fund and Bank. In some cases, this could best be accomplished by a joint approach by the two institutions in support of comprehensive programs.

The United States is also prepared to consider a bolder approach, involving more intensive IMF and World Bank collaboration. We believe that this approach would help ensure that the institutions provide sound, mutually consistent advice on the full range of policies to promote growth.

The United States, which supported African countries with $1.7 billion in bilateral aid in 1985, would be prepared to consider seeking resources in support of such a far-reaching approach if other donors were prepared to make equitable contributions.

We recognize that some may have reservations about such an approach, viewing it as complicated and difficult to implement. I can understand some of those concerns, and believe they suggest the need for further reflection on certain aspects of this proposal. But, we cannot let parochial resistance or unfounded suspicions block an idea that can significantly help the poorest countries and strengthen ties between the Fund and the Bank. I urge you to give this approach further consideration during the months ahead.

## Conclusion

In conclusion, much has been accomplished in the past few years in addressing the pressing economic problems of the early 1980s and preparing the foundation for future global growth. We must now join together to consolidate our progress in building stronger economies for the future.

Sound policies and growth in the industrial world can provide a solid foundation for strengthening and adapting the current international debt strategy. Let us not lose the present opportunity. I have proposed a three-point "Program for Sustained Growth" to provide renewed impetus for resolving the debt problem. We must not deceive ourselves. There are no easy solutions, and none of us can escape our responsibilities.

The principal debtor nations must make the hard policy decisions to restructure their economies. The commercial banks must provide adequate resources to support these efforts. The MDBs must increase the efficiency and volume of their lending.

Moving from proposal to implementation will be a demanding exercise and cannot be accomplished overnight. As we adapt our strategy, we must continue to look to the IMF as the catalyst for new financial flows. And with these new flows will come new hope.

We will be building on the efforts of the past. The needs are clearly recognized by borrowers and creditors alike. Fundamentally, there is no disparity of interest among our nations. We have a common interest in growth--sustained growth that rests on productivity, innovation, and investment. Let us begin our efforts now.