Office Memorandum

To: Members of the Executive Board September 29, 1995

From: The Acting Secretary

Subject: Official and Private Market Financing for Developing Countries and Their Debt Situation - Summing Up

The attached summing up is being revised in order to move to a more suitable position in the text the following sentence:

> Such a situation was seen as representing a very serious problem, to which all Directors considered that the international community should strive to find an appropriate solution.

That sentence was formerly the third sentence of the first paragraph, and has been relocated to become the second sentence of the third paragraph.

Att: (1)

BUFF/95/101
Revised: 9/29/95

September 21, 1995

Summing Up by the Chairman
Official and Private Market Financing for
Developing Countries and Their Debt Situation
Executive Board Meeting 95/88 - September 15, 1995

Executive Directors welcomed Paris Club Naples terms as representing an important breakthrough for most eligible low-income countries toward reducing their external debt burden to sustainable levels. Most Directors agreed that broad coverage under stock-of-debt operations tailored to individual country circumstances, and at least comparable treatment by other bilateral and commercial creditors, would make it possible for many, though not all, eligible countries with strong track records of adjustment to achieve external sustainability. While many Directors agreed with the staff that current mechanisms are sufficiently powerful to handle the debt burdens of most of the heavily indebted poor countries, many other Directors urged the staff to intensify its analysis of the burden implied by multilateral debt, in cooperation with the World Bank and other multilateral institutions, and to consider new mechanisms to ease the multilateral debt burden of the heavily indebted poor countries. All Directors, however, underscored that any new approaches should be consistent with the monetary character of the Fund.

Directors noted that, even after stock-of-debt operations, most heavily-indebted poor countries would remain dependent on aid inflows. They urged donors to increase the share of highly concessional assistance directed to countries persevering with strong adjustment programs, and to continue such assistance after stock-of-debt operations. They also urged these countries to pursue strong adjustment and structural reform policies in order to reach their growth potential and broaden their export base.

Directors, nevertheless, noted that a number of low-income countries would face a heavy debt burden even after a stock-of-debt operation by Paris Club creditors, with comparable action by other official bilateral creditors and by commercial banks, partly due to their high debt to multilateral institutions. Such a situation was seen as representing a very serious problem, to which all Directors considered that the international community should strive to find an appropriate solution. They noted that the circumstances of these countries differed widely, as regards both their largest creditors and the state of their adjustment efforts. Many Directors emphasized, however, that for those countries adopting strong adjustment programs, appropriate instruments were already available to provide both continued flow reschedulings and new inflows, including from multilaterals. It was critical in these cases that new flows be provided in amounts and on sufficiently concessional terms to allow these countries to reach their growth potential. In that context, a number of speakers emphasized the critical importance of the continuation of ESAF. As these countries established track records of adjustment, further consideration might be given by all creditors to concerted action, tailored to a country's needs, to attain external sustainability and a durable exit from the rescheduling process. A number of Directors, however, were of the view that current mechanisms, including the policies of bilateral aid donors and multilateral institutions, needed to be re-examined to assure that a secure path to external sustainability could be established.

Directors noted that the heaviest potential debt burden to the Fund arises in the large protracted arrears cases, for most of which settlement does not appear to be in early prospect.

Directors agreed that concern about the sustainability of both total and multilateral external debt service should be reflected in a focus on these issues in country-specific analysis for the heavily indebted poor countries. Such analysis, to take place in concert by Fund and Bank staff, should focus on the appropriate terms for new borrowing, the sensitivity to changes in assumptions on export and new inflows, the implications of external finance for growth, and the fiscal implications of external debt.

Directors noted that among the countries in transition some of those in the former Soviet Union have rapidly accumulated external debt over the last three years. They urged that debt monitoring and management in these countries be strengthened.

Directors noted the further progress made over the past year in resolving the commercial bank debt problems of developing countries. This progress reflected the strength of the economic policy adjustment pursued in these countries and the flexibility in the menu approach, which allows debt deals to be structured to fit individual countries' needs.

Directors found it encouraging that several low-income developing countries were able to conclude debt buybacks during the past year and that a number of others were actively seeking to reach agreements with their commercial bank creditors. Nevertheless, Directors acknowledged that a few heavily-indebted low-income countries face considerable difficulties in dealing with their commercial bank debts. In these cases, the size of the countries' debts and the secondary market price of the claims tend to make the costs of straight buybacks, even at steep discounts, significantly greater than the financing available. To deal with this problem, it might be necessary for the countries to undertake debt and debt-service reduction operations. Directors emphasized that such operations would have to be carefully designed to ensure that they are consistent with the countries' limited medium-term capacity to service debt and consistent with available financing. Many Directors agreed that the Fund could support debt operations for these countries under its current guidelines through the provision of a small stand-by arrangement, to be augmented in support of the operation, in conjunction with an ESAF arrangement, a few Directors, however, believed that it would be inappropriate for the Fund to extend non-concessional financing to those countries with limited medium-term capacity to service debt.

Directors observed that disruptions that spread across developing country security markets in the aftermath of the Mexican crisis may have reflected the generally less developed state of these markets and certain characteristics of some of the foreign investors in these securities. The experiences of the major developing countries in Asia, where disruptions were short-lived, suggest that in the end securities prices respond primarily to changes in economic fundamentals, underlining the importance of consistent implementation of sound economic policies. This is also borne out by recent developments in international capital markets. Investor interest in developing country securities has been sustained by the continued strong performance of a number of countries and the determined adjustment efforts of those that have encountered difficulties.

In light of recent events, Directors considered it important to remind countries of the need for careful management of the government's external debt. Adequate government supervision of external borrowing by public sector corporations and monitoring of private sector borrowing abroad is essential. Directors also stressed that it was particularly important to carefully supervise the activities of the domestic banking system, since financial difficulties in this sector could limit the ability to conduct monetary policy and entail substantial budgetary costs.