EBS/94/167

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August 23, 1994

To: Members of the Executive Board

From: The Secretary

Subject: Financing for Developing Countries and Their Debt Situation

Attached for consideration by the Executive Directors is a report on financing for developing countries and their debt situation. Conclusions and issues for discussion appear on pages 33-36.

This subject, together with a background paper on private market financing for developing countries (SM/94/224, 8/17/94) and two further background papers on official financing for developing countries and on officially supported export credits (to be issued shortly), is tentatively scheduled for discussion on Friday, September 9, 1994.

Mr. Dunaway (ext. 37343) or Mr. Kuhn (ext. 36555) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

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Financing for Developing Countries and their Debt Situation

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(In consultation with other Departments)

Approved by Jack Boorman

August 22, 1994

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I. Introduction

The last comprehensive review by the Executive Board of progress under the debt strategy and the experience with financing flows to developing countries took place in September 1993. 1/ Since that time, the circumstances and experiences of major groups within the broad range of developing countries have continued to differ, and the issues they face are increasingly diverse. This paper summarizes recent developments and discusses key issues relating to external debt and financing for the major country groups.

Over the past year, there continued to be steady progress towards resolving the commercial bank debt problems of middle-income countries. By early 1995, it is likely that most of the major debtor countries in this group will have restructured their bank debt. This progress, although welcome, should not shift attention away from the number of countries--particularly low-income--that still need to reach agreements with their commercial creditors. Many middle-income countries have also graduated from Paris Club reschedulings with official bilateral creditors.

With their debt restructurings completed, a number of middle-income countries expanded their access to spontaneous private financing, as the investor base for developing country bonds and equities broadened significantly in 1993. Nonetheless, these markets ran into heavy turbulence in the first half of 1994, coincident with higher U.S. interest rates and adverse developments in some borrowing countries. Recent months have brought signs of a recovery in these flows, but immediate prospects remain unclear.

Developing countries--particularly middle-income countries--have also received substantial financial support from official export credit agencies. Over the past six years, commitments by these agencies have almost tripled and officially supported export credits remain a key source of official bilateral assistance for most developing countries. The role of such credits and the limitations of such financing for countries that rely on significant net inflows for prolonged periods are examined in the paper.

By contrast, flows of Official Development Assistance have declined; the debt situation of many low-income rescheduling countries mainly indebted to official creditors has remained difficult and in most of these cases seems unlikely to be resolved definitively without debt-stock reductions along the lines being contemplated by the Paris Club. The paper discusses

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1/ Summing Up by the Chairman (EBM/93/53). See also Financing for Developing Countries and Their Debt Situation, EBS/93/131, August 12, 1993. An update of progress on debt negotiations was provided to the Board in Management of the Debt Situation -- Recent Developments, (EBS/94/59), March 22, 1994.

considerations that should be borne in mind in structuring such operations and assesses their likely impact. It also discusses the role of multilateral institutions in the financing of low-income countries, an issue which is becoming the focus of increasing attention.

The Fund staff has continued to work closely with the staff of the World Bank on debt and financing issues. Following the Fund's decision in January 1994 to modify the guidelines on support for bank debt and debt service reduction operations to eliminate the segmentation provisions, the World Bank made similar modifications to its guidelines in April. 1/ In addition, the Board of Governors of the World Bank agreed at the 1993 Annual Meetings to replenish the initial allocation of US$100 million for the Debt Reduction Facility for IDA countries by another US$100 million.

The paper is organized as follows. Sections II and III discuss developments and issues relating to the restructuring of commercial bank debt and official bilateral debt, respectively, the latter with a particular focus on the low-income countries. Sections IV and V review private and official financing flows to developing countries; Section V focuses in particular on the roles of export credit agencies and multilateral institutions. Section VI presents concluding remarks and issues for discussion.

II. Commercial Bank Debt Restructuring

1. Recent developments

Over the past year, bank debt restructurings were concluded by Brazil, Bulgaria, Jordan, and Zambia. Several other heavily indebted middle-income countries have made substantial progress toward completing debt deals with their commercial bank creditors. Agreements have been reached and bank packages are in the process of being completed for the Dominican Republic (expected completion, end-September 1994), Poland (November 1994), and Ecuador (February 1995). When these packages are completed, a total of 20 countries will have concluded bank debt and debt service reduction operations, restructuring a total of about US$170 billion of debt, roughly 75 percent of the bank debt of the group of heavily indebted developing countries at end-1989 (Table 1). Panama and Peru are the most heavily indebted middle-income countries of this group that have not yet regularized relations with their commercial bank creditors; both are still at an early stage in negotiations.

1/ The modification to the Fund's guidelines is explained in Modalities of Fund Support for Debt and Debt-Service Reduction, (EBS/93/190), November 30, 1993 and Summing Up by the Acting Chairman, (Buff/94/2), January 10, 1994.

Table 1. Commercial Bank Debt and Debt Service Reduction Operations, 1987-July 1994 1/

(In millions of U.S. dollars)

	Debt Restructured Under DDSR Operation 3/ (1)	Debt and Debt Service Reduction (DDSR) 2/ — Debt Reduction: Buy-Back (2)	Debt Reduction: Discount Exchange 4/ (3)	Debt-Service Reduction: Principal Collateralized Par Bond 4/ (4)	Debt-Service Reduction: Other Par Bond 4/ (5)	Prepayments through Collateral-ization (6)	Total (7)=(2)+..+(6)	Total Debt and Debt Service Reduction/ Debt Restructured (7)/(1)	Cost of Debt Reduction 5/
				(Concluded Agreements)					
Argentina (1992)	19,397	--	2,356	4,291	--	2,739	9,386	48.4	3,059
Bolivia	643	331	232	29	--	20	612	95.2	61
(1987)	473	253	182	--	--	7	442	93.5	35
(1993)	170	78	50	29	--	13	170	100.0	26
Brazil (1992)	40,600	--	4,974	3,996	337	3,891	13,198	32.5	3,900
Bulgaria (1993)	6,186	798	1,865	--	421	443	3,527	57.0	652
Chile (1988)	439	439	--	--	--	--	439	100.0	248
Costa Rica (1989)	1,456	991	--	--	101	36	1,128	70.5	196
Guyana (1992)	69	69	--	--	--	--	69	100.0	10
Jordan (1993)	736	--	84	111	--	117	312	42.5	118
Mexico	51,902	--	8,306	7,130	--	7,737	23,173	44.6	7,677
(1988)	3,671	--	1,115	--	--	555	1,670	45.5	555
(1989)	48,231	--	6,838	6,484	--	7,222	20,544	42.6	7,122
Mozambique (1991)	124	124	--	--	--	--	124	100.0	12
Niger (1991)	111	111	--	--	--	--	111	100.0	23
Nigeria (1991)	5,811	3,390	--	651	--	352	4,393	75.6	1,708
Philippines	5,812	2,602	--	516	116	467	3,701	63.7	1,795
(1989)	1,339	1,339	--	--	--	--	1,339	100.0	670
(1992)	4,473	1,263	--	516	116	467	2,362	52.8	1,125
Uganda (1993)	152	152	--	--	--	--	152	100.0	18
Uruguay (1991)	1,608	633	--	160	--	95	888	55.2	463
Venezuela (1990)	19,700	1,411	511	2,012	471	1,639	6,043	30.7	2,585
Zambia (1994)	414	414	--	--	--	--	414	100.0	47
				(Agreements in Process of Conclusion)					
Dominican Republic (1993)	776	272	177	--	--	63	511	65.8	149
Ecuador (1994) 6/	4,471	--	1,207	778	--	583	2,568	57.4	535
Poland (1994) 7/	9,271	1,854	1,840	1,334	77	666	5,770	62.2	1,740
Total	169,678	13,591	21,199	20,362	1,523	18,886	75,560	44.5	24,996

Sources: IMF staff estimates.

1/ Debt and debt service reduction are estimated by comparing the present value of the old debt with the present value of the new claim, and adjusting for prepayments made by the debtor. The methodology is described in detail in Annex I of Private Market Financing for Developing Countries (International Monetary Fund, December 1992). The amounts of debt reduction contained in this table exclude debt extinguished through debt conversions.

2/ The figure for debt service reduction represents the expected present value of the reduction in future interest payments arising from the below-market fixed interest rate path on the new instruments relative to expected future market rates. The calculation is based on the estimated term structure of interest rates at the time of agreement in principle.

3/ Includes debt restructured under new money options for Mexico (1989), Uruguay (1991), Venezuela (1989), and Philippines (1992); the Philippines' (1989) new money option was not tied to a specific value of existing debt.

4/ Excludes prepayment of principal and interest through guarantees.

5/ Cost at the time of operation's closing. Includes principal and interest guarantees, buy-back costs, and for Venezuela, resources used to provide comparable collateral for bonds issued prior to 1990. Excludes cash downpayments related to past due interest.

6/ Based on an assumed allocation of exposure of 60 percent to the discount bond and 40 percent to the par bond.

7/ Uncertain, based on preliminary information regarding allocation of exposure by creditors and assuming that sufficient waivers are obtained for the buyback.

South Africa continued to try to resolve its external debt problems through a rescheduling of its obligations to commercial banks. Agreement on a fourth and final interim arrangement on the 1985 payment "standstill" was reached in September 1993. In the case of Russia, talks have focused on rescheduling the stock of bank debt and capitalizing a declining share of interest arrears, but the preliminary agreement reached in July 1993 has not been implemented. Little progress has been made in discussions with the banks, principally due to differences over the issue of sovereign immunity.

A growing number of low-income countries are making efforts to resolve their debt problems, often aided by the resources of the Debt Reduction Facility for IDA countries, but progress for most remains slow. With the backing of these resources and assistance from official bilateral sources, debt buybacks have been concluded by Bolivia, Guyana, Mozambique, Niger, Uganda, and Zambia. Preparations for an operation with Sao Tome and Principe have been completed. Preparations for operations or preliminary discussions are underway with several other countries.

Further innovations in debt operations have taken place over the past year. Bulgaria's discount bond involves a much steeper discount than in previous debt packages. Poland's agreement was the first to provide for some debt reduction for interest arrears and did not include interest collateral. Packages now generally include limits on the use of certain options or explicit rebalancing clauses to provide countries with more certainty with regard to an operation's upfront costs and the profile of debt service relief that the deal will provide. The Fund and the World Bank have also shown increased flexibility in use of their resources by eliminating the segmentation provisions in their guidelines governing support for bank debt operations. 1/

Over the past year, bank debt operations for Brazil and Jordan were financed entirely by the debtor countries' own resources, as is likely to be the case for the Dominican Republic. While not directly involved in these deals, the international financial institutions have provided some indirect support. The bank deals with Jordan and the Dominican Republic were predicated on Fund arrangements with the countries. In the case of Brazil, the country's stabilization program, which was expected to be monitored by the Fund, and continuing discussions on a Fund arrangement, were considered to provide sufficient assurances to creditors for completion of the debt deal.

1/ Bulgaria is likely to be the first country to benefit from these modifications. Given the level of access under the country's stand-by arrangement, a request for additional resources is expected. Segmentation would have complicated the Fund's ability to support the package, given the banks' large allocation to the discount bond.

2. Issues

Certain recent developments would appear likely to make future negotiations more complex. Nonbank investors now have purchased significant amounts of bank debt in the secondary market. Difficulties in persuading them to accept certain aspects of the debt packages negotiated by bank advisory committees contributed to delays in completing the operations with Argentina and Brazil and pose some problems for Poland. Negotiating committees in the future will have to take better account of the diverse interests of these investors. Another possible complication arises from the market impact of speculation that a country will conclude a debt and debt service reduction operation. This "pre-Brady" speculation has contributed to the runup over the past year in the secondary market prices of Panama's and Peru's bank debt. In recent years, such price runups have tended to occur earlier and to be larger than was the case for the countries that concluded debt packages in 1989 and 1990 (Chart 1). As a consequence, secondary market prices after the runup may not be reflective of a country's medium-term capacity to service its debt, and the upfront costs of an agreement could be bid up significantly. The potential effects of such speculation will need to be taken into consideration in negotiating the terms of bank packages in the remaining cases. Such considerations do appear to have played a role in some earlier agreements (e.g., Poland) which implied buyback equivalent prices below current secondary market prices.

While most of the major bank debt cases have been resolved, attention still needs to be focussed on the problems of the low-income countries. In many of these countries, the process of debt reduction has been delayed owing to difficult economic and political conditions. Although the amounts owed by these countries are small compared to the debt of the large middle-income debtor countries, their individual debt burdens in many cases are more severe. The commercial banks in the past have accepted steep discounts in a few cases, particularly where they do not have significant longer-term business interests and have already provisioned for losses on the debt, but they may need to show additional flexibility in some of the cases that have yet to be addressed.

There will also be a continuing substantial need for concessional resources to finance debt operations. For some low-income countries, the total amount of assistance required to buyback bank debt, even at very steep discounts, is likely to be relatively large, and the resources from the Debt Reduction Facility for IDA countries and bilateral sources may not be sufficient. 1/ In such cases, it may not be appropriate to organize simple buybacks of commercial bank debt. Instead, more complex operations may have to be considered that reduce upfront costs but still provide debt and debt service reduction in line with the a country's payments capacity over the medium-term. Such deals might involve options, in addition to buybacks at steep discounts, that include larger discounts on discount bonds, par bonds bearing lower interest rates, and more favorable treatment of past due interest than in previous packages, and they might provide for less than full collateralization of principal on these bonds to reduce upfront costs.

III. Official Bilateral Debt Restructuring

This section reviews recent developments in debt restructurings with official bilateral creditors and extends the analysis of the debt and financing situation of the low-income rescheduling countries presented in last year's paper. It focuses in particular on issues arising in debt-stock restructurings for low-income rescheduling countries, which are being given intensive consideration by the Paris Club.

1. Recent developments in Paris Club restructurings

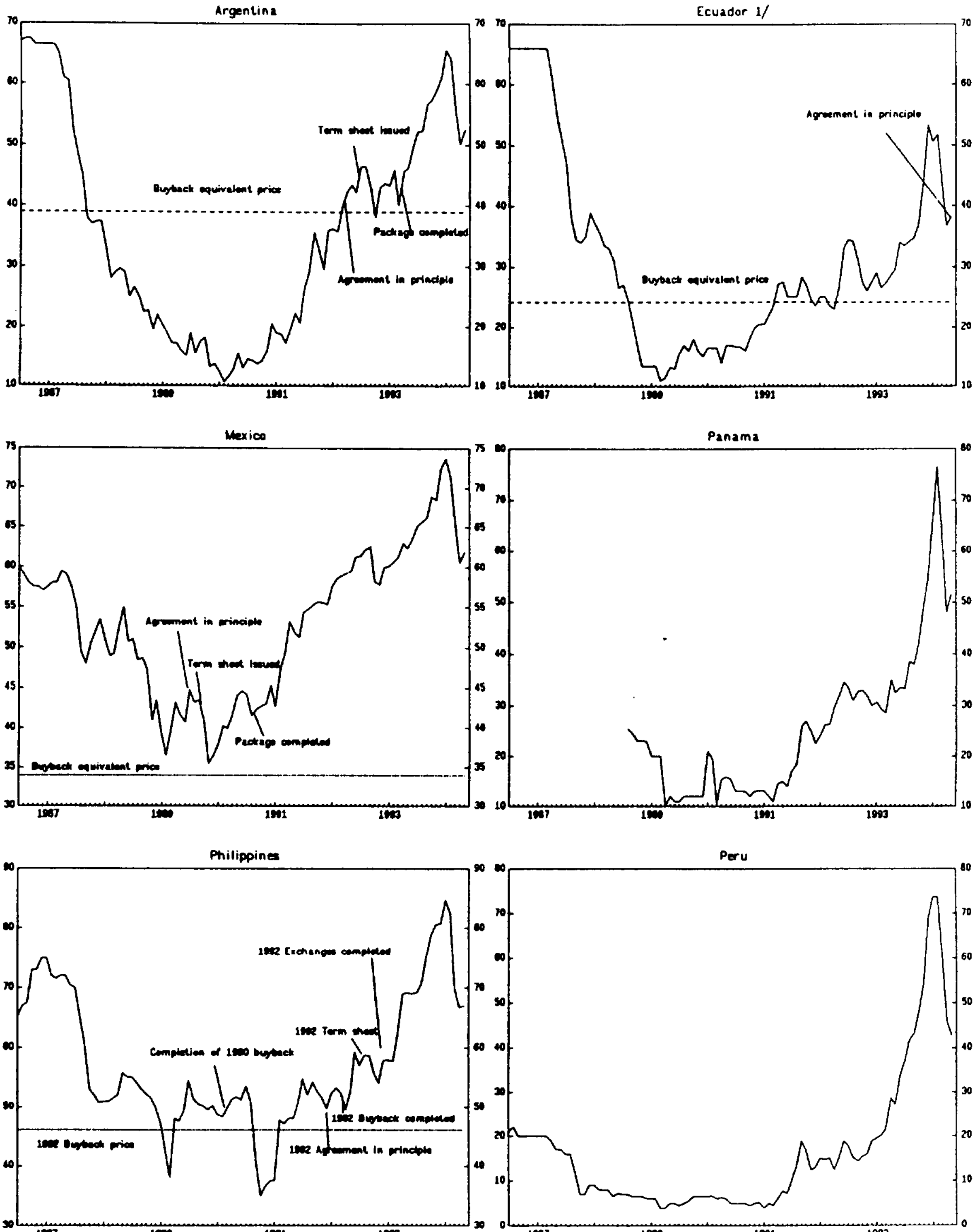
During the past year, substantial progress has been made in debt restructurings with official bilateral creditors. Paris Club creditors concluded 16 rescheduling agreements for a total of US$22 billion, including with three countries which approached the Paris Club for the first time (Algeria, Kenya, and Viet Nam). Four areas of progress stand out. 2/

1/ Nicaragua and Côte d'Ivoire are examples of countries that may face this situation. Each country has relatively sizable debts to commercial creditors, with arrears accounting for a large part of total liabilities. In the case of Nicaragua, the banks have indicated their willingness to engage in a buyback involving a significant discount. However, available financing from the Debt Reduction Facility for IDA countries would amount to only roughly one-quarter of the operation's projected cost, and Nicaragua has had difficulty in raising additional resources. Côte d'Ivoire has begun preliminary discussions with its bank creditors and may face similar circumstances, owing to the size of its debt. Recent increases in the debt's price in the secondary market pose an additional complication.

2/ Details on recent debt restructuring agreements are provided in the background paper "Official Financing for Developing Countries."

CHART 1

SELECTED DEVELOPMENTS IN SECONDARY MARKET PRICES DURING NEGOTIATIONS OF BANK RESTRUCTURING PACKAGES



Sources: Salomon Brothers, ANZ Grindlays Bank; and staff estimates.
1/ Per unit of claim.

First, the number of middle-income countries that continue to require Paris Club reschedulings has declined further. Of the 28 middle-income countries that required Paris Club reschedulings during the past decade, 16 have now graduated (Table 2). Moreover, most of the remaining middle-income cases with agreements now in force are expected to graduate at the end of their current consolidation period.

Second, many countries with continuing debt difficulties and accumulating arrears reached rescheduling agreements over the past year. As a result, only 16 of the 42 rescheduling countries with continuing debt problems are currently without effective agreements and are accumulating arrears. For 10 of these, Fund arrangements are in place or in reasonable prospect and should provide a basis for rescheduling agreements. However, prospects for an early regularization remain uncertain--and in some cases remote--for the remaining 6 cases (Angola, Liberia, Nigeria, Somalia, Sudan, and Zaïre).

Third, creditors have continued to adapt their rescheduling practices to country circumstances, with a particular focus toward modifications in rescheduling coverage and terms to take into account countries' prospects for graduation. Importantly, concessional reschedulings were agreed with Cameroon and Côte d'Ivoire, two countries previously considered lower middle-income countries. In contrast, the reschedulings for Ecuador, Kenya, the Philippines, and Viet Nam were designed as exit reschedulings with relatively limited coverage and/or shorter repayment periods. 1/ For middle-income countries, creditors made increasing use of graduated payments schedules and maturities beyond the previous standard of 10 years. 2/ These graduated schedules, which had been featured in some earlier agreements, have now been incorporated in a number of subsequent agreements.

Finally, creditors continued to provide concessional, and in many cases very comprehensive, reschedulings under the menu of enhanced concessions for the low-income countries. All IDA-only eligible low-income countries that negotiated rescheduling agreements during the past year (with the exception of Kenya) obtained enhanced concessions, and all of these agreements (with

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1/ These reschedulings are exit reschedulings in the sense that they provide for the country to meet its debt-service obligations in full within a defined period; in the cases of Kenya and Viet Nam immediately (as only arrears were rescheduled) and in the cases of Ecuador and the Philippines, at the beginning of 1995 and 1996 respectively--with the agreements covering only part of the periods covered by the respective Fund arrangements.

2/ Graduated (or blended) payments involve shorter grace periods, with total debt-service payments (interest and principal combined) rising steadily over the repayment period.

Table 2. Status of Paris Club Rescheduling Countries (as of July 31, 1994) 1/
(Dates refer to end of current or last consolidation period)

Low-income 2/		Lower middle-income 3/		Other middle-income		Total
		Countries that graduated from reschedulings				
Gambia, The	9/87	Dominican Republic	3/93	Brazil	8/93	
Malawi	5/89	Egypt	6/94 4/	Chile	12/88	
* Viet Nam	12/93 5/	El Salvador	9/91	Costa Rica	6/93 5/	
		Guatemala	3/93 5/	Mexico	5/92	
		Kenya	1/94 5/	Panama	3/92	
		Morocco	12/92	Romania	12/83	
		Poland	3/94	Trinidad and Tobago	3/91	
				Turkey	6/83	
				Yugoslavia	6/89	
Total	3		7		9	19
		Countries with rescheduling agreements in effect				
* Benin	12/95	Congo	5/95	Algeria	5/95	
* Burkina Faso	12/95	Ecuador	12/94	Argentina	3/95	
* Cameroon	9/95	Jamaica	9/95	Bulgaria	4/95	
* CAR	3/95	Jordan	5/97	Gabon	3/95	
* Côte d'Ivoire	3/97	Peru	3/96	Russian Federation	12/94	
* Ethiopia	10/95	Philippines	12/95			
* Guyana	12/94					
* Honduras	7/95					
* Mali	8/95					
* Mauritania	12/94					
* Mozambique	12/94					
* Niger	3/95					
* Senegal	3/95					
* Sierra Leone	12/95					
* Zambia	3/95					
Total	15		6		5	26
		Countries with previous rescheduling agreements, but without current rescheduling agreements, which have not graduated from reschedulings				
Angola	9/90	Nigeria	3/92			
* Bolivia	5/94 6/					
Chad	12/90 7/					
* Equatorial Guinea	12/92 7/					
* Guinea	12/92					
Guinea-Bissau	12/90					
Liberia	6/85					
Madagascar	6/91					
* Nicaragua	3/93 7/					
Somalia	12/88					
Sudan	12/84					
* Tanzania	6/94					
* Togo	6/94					
* Uganda	6/94 6/					
Zaïre	6/90					
Total	15		1		-	16
All countries	33		14		14	61

1/ Includes agreements of the Russian Federation and Turkey with official bilateral creditors.
2/ Asterisk denotes rescheduling on enhanced concessional terms.
3/ Defined here as countries that obtained lower middle-income but not concessional terms with Paris Club reschedulings.
4/ Last stage of debt reduction under 1991 agreement not yet implemented.
5/ Rescheduling of arrears only.
6/ Consolidation periods were extended.
7/ Fund arrangements in place, rescheduling expected shortly.

the exception of the exit rescheduling for Viet Nam) featured a goodwill clause envisaging a stock-of-debt operation after a period of three years of good performance under Fund arrangements and the rescheduling agreement. 1/

However, no stock operations have yet been implemented. At their recent summit meeting in Naples, G-7 leaders encouraged "the Paris Club to pursue its efforts to improve the debt treatment of the poorest and most indebted countries" and favored "where appropriate, a reduction in the stock of debt and an increase in concessionality for those countries facing special difficulties." Some issues that arise in connection with debt-stock operations are discussed in section 4 below.

2. Non-Paris Club bilateral creditors

Less progress has been made by debtors in negotiations with non-Paris Club official bilateral creditors. 2/ The background paper on official financing describes agreements that have been reached between certain debtors and non-Paris Club creditors over the past year. However, in a number of cases, progress toward reaching agreements with some major creditors has been very slow. Paris Club comparability provisions prevent the debtor from agreeing more favorable terms (from the viewpoint of the creditor) with any bilateral creditor. In a number of countries facing particularly severe debt and financing problems and with large obligations to non-Paris Club official bilateral creditors, debt restructuring by these creditors would need to take fully into account these countries' limited capacity to repay. It is encouraging that negotiations in some cases have recently intensified, and an early resolution of issues on outstanding liabilities would be highly desirable so that normal relations with all creditors are restored and debt-service obligations fully incorporated into medium-term macro-frameworks.

1/ In the case of Cameroon, creditors only agreed in principle to consider holding a meeting on Cameroon's stock of debt, while in the 1994 agreement with Sierra Leone, the stock operation is envisaged for end 1995, slightly later than three years after the November 1992 agreement.

2/ Under the Fund's long-standing practice of treating such creditors in parallel with Paris Club creditors, debts under negotiation with non-Paris Club creditors are not treated as arrears for program monitoring purposes during the period specified in the Paris Club Agreed Minute for completing bilateral negotiations. If no agreement with non-Paris Club creditors is reached within this period, arrears will exist for program monitoring purposes unless the debtor is judged to be making best efforts towards a resolution.

3. Lower middle-income countries

The experiences of the lower middle-income rescheduling countries have been marked by further differentiation during the past year. As noted earlier, the Philippines and Ecuador obtained exit reschedulings, while Cameroon and Côte d'Ivoire received enhanced concessional terms. With the notable exception of Nigeria, all of the remaining lower middle-income rescheduling countries have agreements currently in place (Table 2). Assuming sustained and strengthened adjustment efforts, there is the prospect that some, if not all, of these countries could exit from the rescheduling process at the end of their current consolidation periods or soon thereafter.

4. Low-income rescheduling countries

The menu of enhanced concessions for low-income countries adopted by Paris Club creditors in 1991 envisages stock-of-debt operations after three years of good performance under Fund arrangements and rescheduling agreements. 1/ A number of these countries are now nearing the end of the three-year waiting period specified in their agreements (Table 3). Moreover, several countries--notably Bolivia, Guyana, and Uganda--have already made significant progress under Fund-supported programs and have established a good record of performance in implementing rescheduling agreements. In the light of these developments and the outcome of the recent Naples Summit, Paris Club creditors have recently intensified their consideration of the modalities of stock-of-debt operations and further methodology discussions are planned for late September. This section considers the case for debt-stock operations, discusses general considerations that should be borne in mind by both creditors and debtors in approaching such operations, and assesses the likely impact of stock-of-debt reductions, undertaken in line with the menu of enhanced concessions currently agreed by the Paris Club.

1/ This section focuses on the group of low-income rescheduling countries as these are the countries most likely in the foreseeable future to meet these criteria of satisfactory track records under both Fund arrangements and rescheduling agreements. The recent World Bank paper "Toward Resolving the Debt Problem of Severely Indebted Low-income Countries" (publication forthcoming) adopts a different approach of considering the need for debt reduction from the perspective of the debt burden faced by all low-income countries, rather than focussing on the countries most likely to be in a position to qualify in the near future for stock-of-debt operations according to Paris Club criteria. The respective country coverage under the two approaches is discussed in the background paper on official financing (Annex, Section II).

Table 3. Low-Income Rescheduling Countries: Consolidation Periods and Dates for Possible Debt-stock Operations 1/

	Date of possible debt-stock operation specified in latest Agreed Minute 2/	End of current or last consolidation period	Period between end of consolidation period and stock-of-debt operation (in months)	Current and prospective (...) Fund arrangement	
				Type	Arrangement 3/
Nicaragua	12/94	3/93	21	ESAF	6/97
Bolivia	1/95	5/94 4/	8	ESAF	...
Tanzania	1/95	6/94	7	...	...
Uganda	6/95	6/94 4/	12	ESAF	...
Togo	6/95	6/94	12	...	...
Zambia	7/95	3/95	4	RAP 5/	3/95
Mali	10/95	8/95	2	ESAF	8/95
Honduras	10/95	7/95	3	ESAF	7/95
Guinea	11/95	12/92	35	ESAF	11/94 6/
Benin	12/95	12/95	--	ESAF	1/96
Ethiopia	12/95	10/95	2	SAF	10/95
Sierra Leone	12/95 2/	12/95	--	ESAF	3/97
Mauritania	1/96	12/94	13	ESAF	5/92 7/
Mozambique	3/96	12/94	13	ESAF	5/93 8/
Burkina Faso	5/96	12/95	5	ESAF	3/96
Guyana	5/96	12/94	17	ESAF	7/97
Cameroon	3/97 2/	9/95	18	SBA 5/	9/95
Senegal	3/97	3/95	24	SBA 5/	3/95
Niger	3/97	3/95	24	SBA 5/	3/95
Côte d'Ivoire	3/97	3/97	--	ESAF	3/97
C.A.R.	4/97	3/95	25	SBA 5/	3/95

1/ In accordance with normal Paris Club practice to base a rescheduling on agreed terms of reference when the number of creditors involved is very small, the 1992 rescheduling for Equatorial Guinea was not based on a full-fledged Agreed Minute. Equatorial Guinea obtained enhanced concessions but no date for a stock-of- debt operation was specified in the terms of reference. Chad, which is in a similar position, has a stand-by arrangement but has yet to conclude a rescheduling agreement.

2/ The Paris Club Agreed Minutes incorporating enhanced concessions generally state that creditors would meet to *consider the matter of debtor countries' stock of debt if for three years following* the signing of the Agreed Minute debtor countries maintained satisfactory relations with the participating creditors, fully implemented all agreements signed with them and continued to have an appropriate arrangement with the Fund. The clause for Cameroon was weaker, with creditors agreeing in principle to consider holding a meeting on the matter of the stock of debt. The 1994 agreement with Sierra Leone runs to slightly beyond the November 20, 1995 date for a stock operation envisaged under the 1992 agreement; under the 1994 agreement the date for the goodwill clause was moved to the end of the consolidation period (end 1995).

3/ End of original arrangement period.

4/ Consolidation period was extended.

5/ These arrangements are expected to be replaced by ESAF arrangements.

6/ A second annual ESAF arrangement is expected to approval in September 1994, together with an extension of the original commitment period until June 1996.

7/ Mauritania's third annual arrangement was approved on 1/26/94.

8/ Mozambique's additional annual arrangement was approved on 6/15/94.

a. The case for debt-stock operations

While an increasing number of middle-income countries have graduated or are close to graduating from the rescheduling process, graduation remains a distant prospect for most of the low-income rescheduling countries given current profiles of scheduled debt service. 1/ For most of these countries, current levels of originally scheduled debt service appear unsustainable and, indeed, are not being paid. For low-income rescheduling countries as a group, scheduled debt service in 1993 averaged around 60 percent (compared to actual debt service payments of 20 percent) of exports of goods and services (Table 4). 2/ In some countries, external debt service also represents a heavy fiscal burden, with public sector debt-service obligations high in relation to GDP or revenues. 3/

The debt "overhang" has likely contributed to uncertainty about economic prospects in the most heavily indebted countries, delaying investment and private capital inflows (including in some cases the return of flight capital) required to generate sustainable growth. 4/ In addition, repeated debt reschedulings continue to involve significant costs for policymakers (including the use of scarce governmental/administrative talent) and create uncertainty about future debt relief; they may also foster the belief on the part of borrowers that financial contracts need not be honored.

For many of the low-income rescheduling countries, there appears to be little realistic alternative to resolution of these difficulties through debt-stock operations along the lines being considered by bilateral creditors (accompanied, as appropriate, by operations vis-à-vis bank creditors). Definitive debt-stock operations can provide the prospect of returning debtors to normal relations with the international financial community, characterized by spontaneous financial flows and the full honoring of loan contracts. There would appear a strong case for early debt-stock operations for countries that have already established suitable track records--such as Guyana and Uganda, and Bolivia once a Fund program is agreed. Early operations for such countries, where the track record is well established, would send a clear signal to other debtors in similarly

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1/ Of 33 low-income countries that have rescheduled, only three have graduated (Table 2).

2/ The 1993 pattern is broadly representative of the medium-term debt service profile.

3/ Creditors have not accepted, except in the limited case of CFA Franc countries, that fiscal considerations provide a basis for external debt rescheduling.

4/ See for example, "Market Valuation of External Debt" by Michael P. Pooley in "Analytical Issues in Debt" Edited by Messrs Frenkel, Pooley and Wickham, IMF 1989.

Table 4. Low-Income Rescheduling Countries: Structure of External Financing, 1993 1/

(In percent of exports of goods and services) 2/

	Noninterest current account deficit (-: surplus)	Total scheduled debt service	Financing: Total	Financing: Grants	Financing: Disbursements	Financing: Exceptional 3/	Financing: Other 4/	Memo: Actual debt service 5/
Angola	17	63	80	--	14	49	17	14
Benin	37	14	51	34	22	7	-12	7
Bolivia	55	50	104	24	35	30	15	20
Burkina Faso	126	19	144	100	46	10	-12	9
Cameroon	28	58	86	8	17	42	19	16
C.A.R.	62	23	85	61	14	16	-6	7
Chad	144	23	167	92	38	16	20	7
Côte d'Ivoire	2	59	61	3	19	39	--	20
Equatorial Guinea	51	41	92	57	25	36	-26	5
Ethiopia	98	72	170	78	66	38	-13	34
Guinea	48	29	77	18	31	9	19	20
Guinea-Bissau	146	139	285	120	61	124	-21	15
Guyana	3	34	37	1	22	10	4	24
Honduras	19	37	56	9	31	8	8	29
Madagascar	36	72	108	30	24	61	-7	11
Mali	69	35	104	55	22	26	1	9
Mauritania	31	41	72	24	28	7	12	34
Mozambique	176	134	310	135	56	104	15	30
Nicaragua	117	291	408	66	39	237	65	54
Niger	46	35	81	48	16	19	-1	16
Senegal	34	24	57	21	17	13	6	11
Sierra Leone	41	44	85	15	25	34	11	10
Tanzania	71	51	122	54	18	34	17	17
Togo	27	37	65	10	1	31	22	6
Uganda	147	85	232	126	112	20	-26	65
Zaire	-3	117	113	1	3	112	-2	4
Zambia	21	62	84	36	22	28	-3	34
Average	61	62	123	45	31	43	5	20

Source: Fund staff estimates.

1/ For a discussion of country coverage, see background paper on official financing (Annex, Section II). For certain countries, coverage is of fiscal year (see Table 5).

2/ In some cases, in percent of exports of goods and nonfactor services.

3/ Includes debt relief and change in arrears.

4/ Including net changes in reserves, but excluding Fund repurchases and repayments which are included under debt service.

5/ Consists of scheduled debt service less debt relief and change in arrears.

difficult debt situations that appropriate policies elicit appropriate international support. Creditors should also consider in the near future debt-stock operations with other countries as they establish appropriate track records.

b. General approach

The objective of a debt-stock operation should be to provide the debtor country with a medium-term debt-service profile that, with sound policies, can be sustained. 1/ While low-income rescheduling countries face a wide diversity of situations and prospects, nearly all remain highly dependent on large net resource flows, with non-interest current account deficits averaging (in 1993) 60 percent of current exports of goods and services (Table 4). With few exceptions, new financing has greatly exceeded actual debt service (Chart 2), and has, in a number of cases, been motivated in part by the high debt-service burden of the country concerned. Given the need to sustain or increase import levels to permit growth, there are limits to the rate at which non-interest current account deficits can be reduced, even with rapid export growth and diversification. Accordingly, debt reduction should be carried out in a way which encourages a continuation of concessional resource flows. This implies, prima facie, the maintenance of cutoff dates. 2/ Furthermore, the heavy dependence on new inflows and the existing debt burden of many of the countries concerned severely limit the scope for debt-creating flows unless they are provided on highly concessional terms.

For debtor countries, a key part of the process is a determined effort to strengthen their adjustment efforts in order to meet the (reduced) debt-service obligations and tailor their need for future resource transfers to the levels that donors are prepared to provide on appropriately concessional terms. Particular attention needs to be given to policies that will strengthen domestic savings and facilitate private sector flows.

There are various steps that can be taken to help ensure that countries in fact graduate from the rescheduling process via a debt-stock operation. To permit countries to cope with external shocks, the medium-term scenarios

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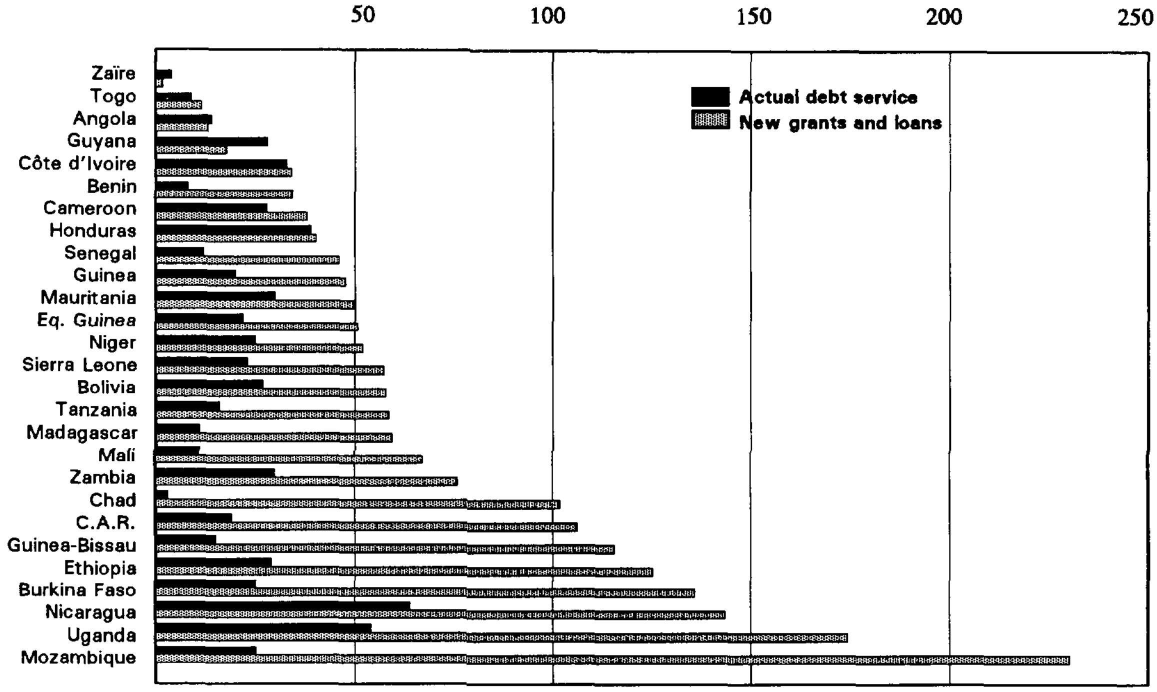
1/ The recent World Bank paper "Toward Resolving the Debt Problem of Severely Indebted Low-income Countries" (SILICs) proposes a framework for resolution of the SILIC debt problem. The paper emphasizes that a resolution of the debt problem needs to be tailored to individual country circumstances; as a guide to this resolution, the paper suggests the use of a debt-to-exports ratio on a present value basis as an indicator of the severity of debt overhangs. The background paper on official financing (Annex, Section II) describes the proposals in the Bank paper and looks at the concept of debt-to-exports ratios on a present value basis.

2/ Changing the cutoff date would not yield much additional by way of debt-service reduction, as can be seen from projected debt-service on post cutoff date debt in 1994 (Table 5 column 4).

Chart 2: Low-Income Rescheduling Countries: Projected Actual Debt-Service Payments and New Financing, 1994

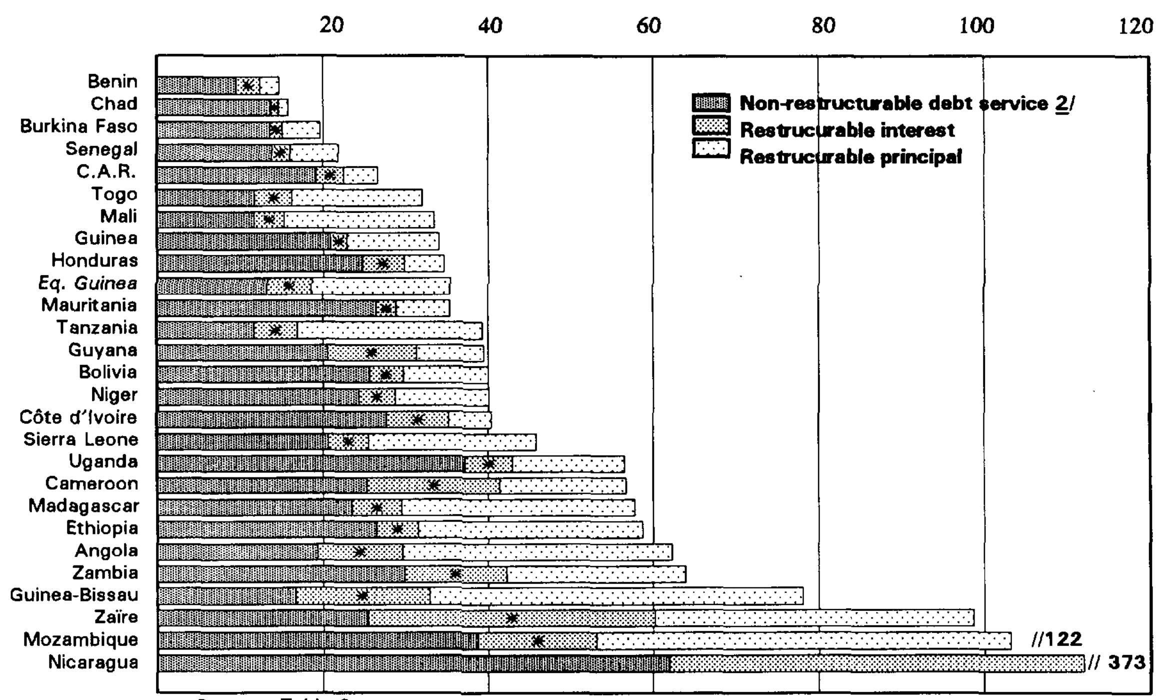
(In percent of exports of goods and services)



Source: Table 6.

Chart 3: Low-Income Rescheduling Countries: Structure of Scheduled Debt-Service Payments, 1994

(In percent of exports of goods and services)



Source: Table 6.

1/ The debt-service structure for 1994 is broadly representative of the medium-term profile.

2/ For details see Chart 4.

* Debt service payments after bilateral debt-stock restructurings on the basis of a 50 percent net present value reduction.

Table 5. Low-Income Rescheduling Countries:
Structure of Scheduled Debt Service, 1994 1/

(In percent of exports of goods and services) 2/

Country	Scheduled debt service								
	Nonrestructurable debt					Restructurable debt 4/			Total
	Total	of which:				Total	of which:		
		IMF	Other multilaterals	Post-cutoff	Other 3/		Principal	Interest	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Angola	19	--	--	3	16 5/	43	33	10	62
Benin	10	--	4	--	5	5	2	3	15
Bolivia	26	2	18	--	5	14	10	4	40
Burkina Faso	14	--	9	--	4	6	4	2	20
Cameroon 6/	25	1	9	5	10 7/	31	15	16	57
Central African Republic	19	4	8	4	3	7	4	3	27
Chad	14	2	8	--	4	2	1	1	16
Côte d'Ivoire	28	3	14	5	6	13	5	8	40
Equatorial Guinea	13	1	8	--	3	22	17	5	35
Ethiopia 6/8/	26	--	9	--	18 9/	32	27	5	59
Guinea	21	1	6	1	13 10/	13	11	2	34
Guinea-Bissau	17	1	13	--	3	61	45	16	78
Guyana	21	6	11	2	2	19	8	11	39
Honduras	25	2	18	1	4	10	5	5	35
Madagascar	24	2	8	4	10 11/	34	28	6	58
Mali	12	2	6	2	2	22	18	4	33
Mauritania	27	2	16	--	9	9	6	2	35
Mozambique	39	3	7	4	24 12/	83	68	14	122
Nicaragua	62	1	37	1	22 13/	310	228	82	372
Niger	24	4	12	2	6	16	11	4	40
Senegal	14	2	7	1	4	8	6	2	22
Sierra Leone	21	3	4	1	13 14/	25	20	5	46
Tanzania 6/	12	1	5	--	5	28	22	5	39
Togo	12	3	5	1	4	20	16	5	32
Uganda 6/	37	4	20	6	8	19	14	6	56
Zaïre	25	6	7	6	7	73	39	35	99
Zambia	30	4	16	3	7	34	22	12	64

Source: Fund staff estimates.

1/ For a discussion of country coverage, see the background paper on official financing (Annex, Section II).
2/ In some cases, in percent of exports of goods and nonfactor services.
3/ Includes short-term debt and other debt which have been excluded explicitly or implicitly from rescheduling, such as private sector debts as well as debt service from previous concessional rescheduling on Toronto terms or on enhanced concessions. For cases where debt service is large, details are provided in the footnotes.
4/ Includes pre-cutoff date debt to Paris Club, other official bilateral, and private creditors.
5/ Includes debt service on oil-securitized debt (5 percent).
6/ For fiscal year 1993/94.
7/ Includes debt service on private and petroleum sector debts (2 percent).
8/ Excludes debt service on ruble-denominated debt to FSU because of lack of data.
9/ Includes debt service on Ethiopian Airlines' debt (12 percent).
10/ Includes debt service on mining companies' debt (9 percent).
11/ Includes debt service on previously rescheduled debt on Toronto terms (5 percent).
12/ Includes debt service on previously rescheduled debt on Toronto terms and on enhanced concessions (24 percent).
13/ Includes debt service on previously rescheduled debt on enhanced concessions (8 percent), and on new borrowing from regional creditors.
14/ Includes debt service on previously rescheduled debt on enhanced concessions including deferred payments of moratorium interest (10 percent).

on which debt reduction are based should include an adequate reserve build-up. In addition, the profile of debt service payments on restructured debt should rise only gradually, and existing humps in debt service profiles (in some cases such as Madagascar, Mozambique, Zaïre, and Zambia arising from payments on debt previously restructured on Toronto terms) should be smoothed out as part of the debt-restructuring operation. Creditors should also err on the side of caution in the debt service they seek post debt reduction: expectations of large future gains to creditors from countries' adjustment efforts following the initial adjustment period should be avoided. Overambitious repayments schedules are likely to be counter-productive. If debt-servicing capacity expands faster than originally anticipated for a particular debtor, this could reduce the need for future net transfers in the form of grants and concessional loans and provide a basis for access to more diversified sources of financing.

The acceptability and sustainability of stock-of-debt operations would be enhanced by such operations being provided only to debtors with a good track record; by creditors re-establishing closer links between payments performance and the provision of new financial assistance; and by medium-term adjustment paths agreed with the Fund, along with the financing framework put in place through the Consultative Group mechanism, being fully consistent with adherence to the agreed payments schedule together with realistic estimates of new financial flows.

Even a well-designed approach to stock-of-debt operations does not, of course, ensure that countries would no longer encounter payments difficulties as a result, for example, of severe external shocks or major policy slippages. Such difficulties would, as now, need to be dealt with through an appropriate mix of adjustment and financing. But with the essential debt problem having been resolved, this should not involve a return to debt rescheduling.

c. Assessment of stock-of-debt operations

Charts 3 and 4 and Table 5 show the structure of total and nonrestructurable scheduled debt-service payments for 1994 for low-income rescheduling countries. 1/ 2/ Based on this data, the effects of bilateral debt-stock restructurings on the basis of an illustrative 50 percent net present value reduction by Paris Club and other bilateral creditors are shown in Chart 3 and Table 6 (in Chart 3, the resulting

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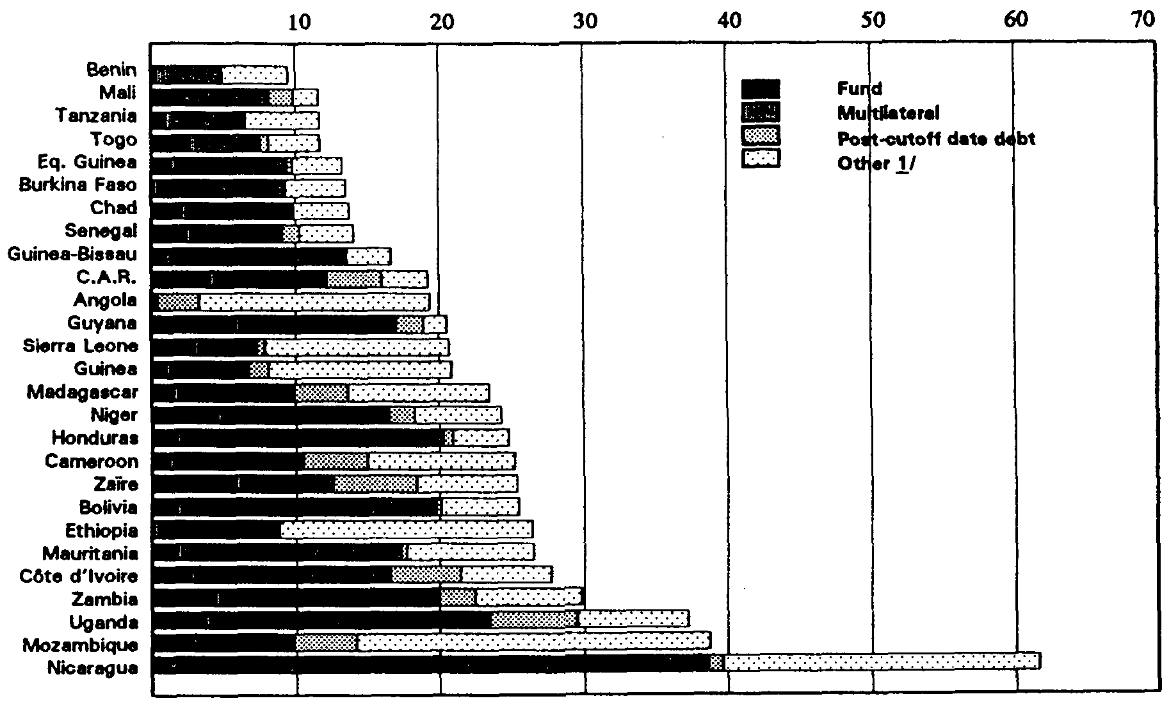
1/ A review of medium-term scenarios presented in recent Board papers confirms that the structure of debt service in 1994 is broadly representative of the medium-term profile, assuming repeated flow reschedulings on enhanced concessional terms.

2/ The bulk of nonreschedulable debt service is to multilaterals which is discussed in section V.3 below. The background paper on official financing (Annex, Section I) contains a discussion of the other components of nonrestructurable debt service.

Chart 4: Low-Income Rescheduling Countries: Structure of Debt-Service Payments on Non-Restructurable Debt, 1994

(In percent of exports of goods and services)



Source: Table 5.

1/ Include short-term debt and other debts which have been excluded explicitly or implicitly from rescheduling, such as private sector debts as well as debt service from previous concessional rescheduling on Toronto terms or on enhanced concessions.

Table 6. Low-Income Rescheduling Countries: Effects of Debt-Stock Operations, 1994 1/

(In percent of exports of goods and services) 2/

Country	Scheduled debt service: Non-restructurable debt	Scheduled debt service: Restructurable debt 3/ Principal	Scheduled debt service: Restructurable debt 3/ Interest	Debt service after a hypothetical 50 percent stock-of-debt operation: Restructurable debt	Debt service after a hypothetical 50 percent stock-of-debt operation: Total	Memorandum: Actual debt service in 1994 5/	Grants and loan disbursements 6/
	(1)	(2)	(3)	(4) 4/ =50% of (3)	(5) =(1)+(4)	(6)	(7)
Angola	19	33	10	5	24	14	13
Benin	10	2	3	1	11	8	34
Bolivia	26	10	4	2	28	27	58
Burkina Faso	14	4	2	1	14	25	136
Cameroon	25	15	16	8	33	28	38
Central African Republic	19	4	3	2	21	19	106
Chad	14	1	1	--	14	3	102
Côte d'Ivoire	28	5	8	4	32	33	34
Equatorial Guinea	13	17	5	3	16	22	51
Ethiopia	26	27	5	3	29	29	125
Guinea	21	11	2	1	22	20	48
Guinea-Bissau	17	45	16	8	25	15	116
Guyana	21	8	11	5	26	28	18
Honduras	25	5	5	2	27	39	40
Madagascar	24	28	6	3	27	11	59
Mali	12	18	4	2	14	11	67
Mauritania	27	6	2	1	28	30	50
Mozambique	39	68	14	7	46	25	230
Nicaragua	62	228	82	41	103	64	144
Niger	24	11	4	2	27	25	52
Senegal	14	6	2	1	15	12	46
Sierra Leone	21	20	5	2	23	23	57
Tanzania	12	22	5	3	14	16	59
Togo	12	16	5	2	14	9	12
Uganda	37	14	6	3	40	54	174
Zaïre	25	39	35	17	43	4	2
Zambia	30	22	12	6	36	30	76

Source: Fund staff estimates.

1/ For a discussion of country coverage, see the background paper on official financing (Annex, Section II). For certain countries coverage is of fiscal year (see Table 5).
2/ In some cases, in percent of exports of goods and nonfactor services.
3/ Includes pre-cutoff date debt to Paris Club, other official bilateral, and private creditors.
4/ The debt is assumed to be restructured into a mortgage-type repayment schedule under which principal payments would initially be eliminated or restructured to a very small fraction of the restructured debt stock. Hence, in the early years post a debt-stock operation, payments on restructured debt would be limited to about 50 percent of currently scheduled interest payments. For further background, see the background paper on official financing, Annex, Section III. These payments would be expected to rise by around 3 percent a year in nominal terms (see Chart 5).
5/ Consists of scheduled debt service less debt relief and change in arrears. Projections for those countries which had either a Fund program or an effective debt rescheduling covering at least part of 1994, otherwise actual debt service in 1993.
6/ From official bilateral and multilateral sources, excluding the Fund.

obligations are indicated by an asterisk). Such a 50 percent stock reduction would lower debt service on restructured debts to well below 5 percent of exports of goods and services for many of the low-income rescheduling countries. With the repayment profile currently incorporated in the Paris Club's flow-reschedulings (23 years with graduated repayments), debt-service obligations would rise, following stock reductions, at about 3 percent per annum in nominal terms (Chart 5). This would be consistent with an unchanged or decreasing debt-service ratio on restructured debt over the medium term as long as nominal exports grow at a rate of at least 3 percent. 1/

For most countries, debt service on restructured debt after a 50 percent debt-stock operation should fall to quite low levels. Moreover, such debt-stock reductions would leave most of these countries with a total debt burden that appears sustainable.

Important caveats attach to these general conclusions:

- the calculations are unavoidably approximate and assume comparable treatment by non-Paris Club official bilateral creditors and effective coverage of pre-cutoff date ODA debt; 2/

- a number of countries will require substantially larger debt and debt service reductions by bilateral creditors to bring debt profiles to manageable levels even in the context of strong and determined adjustment efforts. Clear examples include Mozambique, Nicaragua, and Zaïre; 3/

- conversely, some countries might manage with lower--and in some cases zero--debt reductions, such as Benin, Burkina Faso, and Chad, which all have debt-service ratios (pre-debt reduction) of 20 percent or less; 4/

1/ The background paper on official financing (Annex, Section I) examines the medium-term impact of stock-of-debt operations for selected low-income rescheduling countries.

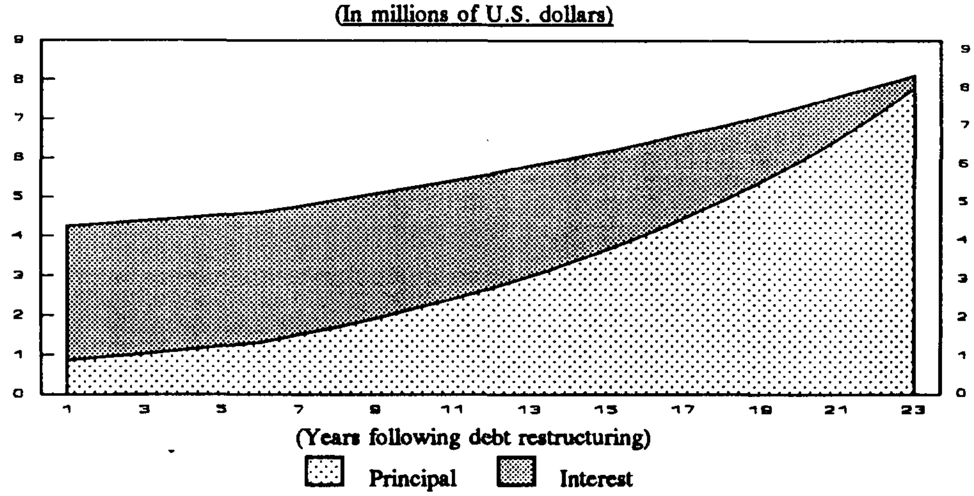
2/ This could be achieved, for example, by rescheduling ODA obligations at concessional interest rates on similar terms as for current enhanced concessions flow reschedulings.

3/ This also holds for Liberia, Somalia, and Sudan.

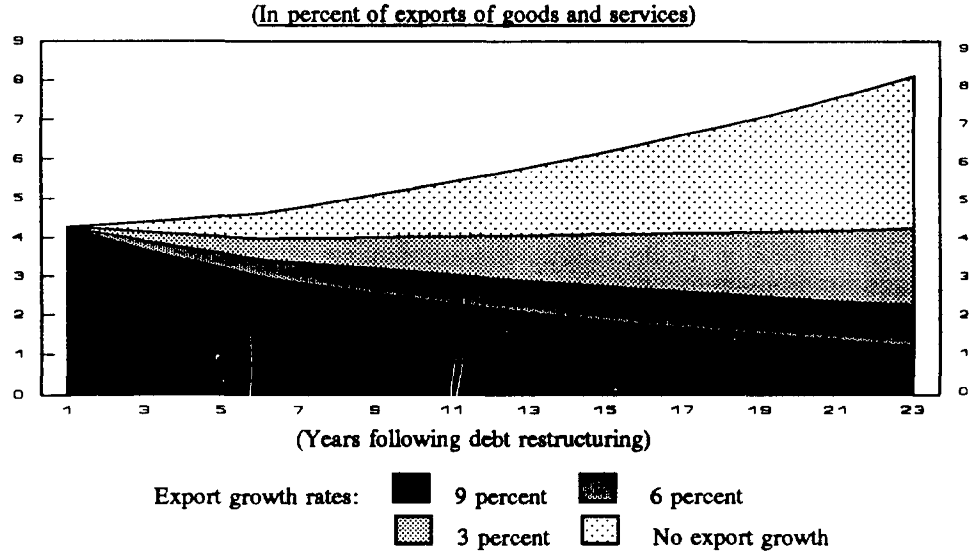
4/ This also applies to some other nonrescheduling low-income countries classified as severely indebted by the World Bank such as Ghana, Kenya, Lao P.D.R., and Viet Nam (which had an exit rescheduling effectively involving debt reduction) as well as Egypt which has already secured debt reduction.

Chart 5. Debt Service Profile and Export Growth After Debt Restructuring 1/

(In millions of U.S. dollars)



(In percent of exports of goods and services)



Source: Fund staff estimates.

1/ Assuming a restructuring of US$100 million in debt on the terms currently applied under enhanced concessional terms on a flow basis with a reduction of 50 percent in NPV terms; a market rate of 9 percent; an equal distribution over the debt reduction and debt service reduction options; initial exports of US$100 million.

- the bilateral debt problems of a number of countries whose debt-service ratios remain problematic after a debt stock operation are largely with respect to creditors that do not participate in the Paris Club, and these cases will require special action outside that forum (as noted in section 2 above);

- several countries are heavily indebted to multilateral creditors and are therefore particularly dependent on adequate new financing on appropriate terms (see section V.3 below).

IV. Private Financing Flows

1. Recent developments

The resurgence in private market financing to developing countries that began in the late 1980s continued during 1993, reaching a peak in the fourth quarter of the year; in 1993, both portfolio flows and net foreign direct investment rose sharply. 1/ The strong expansion in international bond and stock placements during 1993 was fueled in large part by a broadening of the investor base to include a wider group of institutional investors. 2/ Medium- and long-term commercial bank lending remains limited. While total private market financing for developing countries as a group increased strongly in 1993, the majority of these flows continued to go to a relatively small number of countries, primarily in Asia and Latin America.

Toward the end of 1993 and in early 1994, spreads on bonds narrowed appreciably. Demand for developing country bonds and equities began to fall dramatically in early February 1994, however, coincident with the increase in U.S. interest rates and adverse developments in some borrowing countries (Chart 6). In addition, highly leveraged investors are reported to have sold their positions in emerging markets securities to meet margin requirements or to take profits to offset losses in other markets. The slide in demand for developing country bonds and equities continued through April 1994, before recovering moderately in May and June. The market remains unsettled and its future course unclear.

1/ International bond and equity flows amounted to US$71 billion in 1993 (US$33 billion in 1992); net foreign direct investment flows amounted to US$58 billion (US$39 billion in 1992). Direct purchases of equity and bonds by non-residents in local markets are not accounted for because of the lack of sufficient data.

2/ The expansion of the investor base is discussed in International Capital Markets - Developments, Prospects, and Key Policy Issues, (EBS/94/113), May 31, 1994.

While countries with weaker economic performance (such as Hungary and Turkey) experienced cutbacks in market access somewhat earlier than others, financing flows to all developing countries, including those in Asia and the stronger performers in Latin America, fell to very low levels by April 1994; both issuers and purchasers pulled back sharply in the wake of the uncertainties in the market. Bonds placed after February tended to carry floating interest rates and shorter maturities, and they were issued by higher quality credit risks. The investor base, however, remained relatively stable. Highly leveraged investors may have unwound most of their positions, but it appears that most of the institutional investors have maintained their positions, although they curtailed their demand for new bonds and equity issues.

2. Issues

The expansion in private financing to developing countries over the past few years and the market's ability to rebound from a moderate correction in 1992 1/ gave reasons for optimism about the sustainability of the process of market re-entry. While the sharp correction in early 1994 raised some doubts, the emergence of a recovery in May and June reinforces that optimism. As noted in previous reports, three conditions appear basic to sustaining private flows to developing countries: an expanded investor base; appropriate pricing and assessment of risk; and continued implementation of sound policies in the issuing countries, which, inter alia, should be intended to help match future debt servicing requirements to payments capacity. Progress has been made generally along these lines over the past year, yet elements remain that suggest that the market will continue to be susceptible to sizable fluctuations.

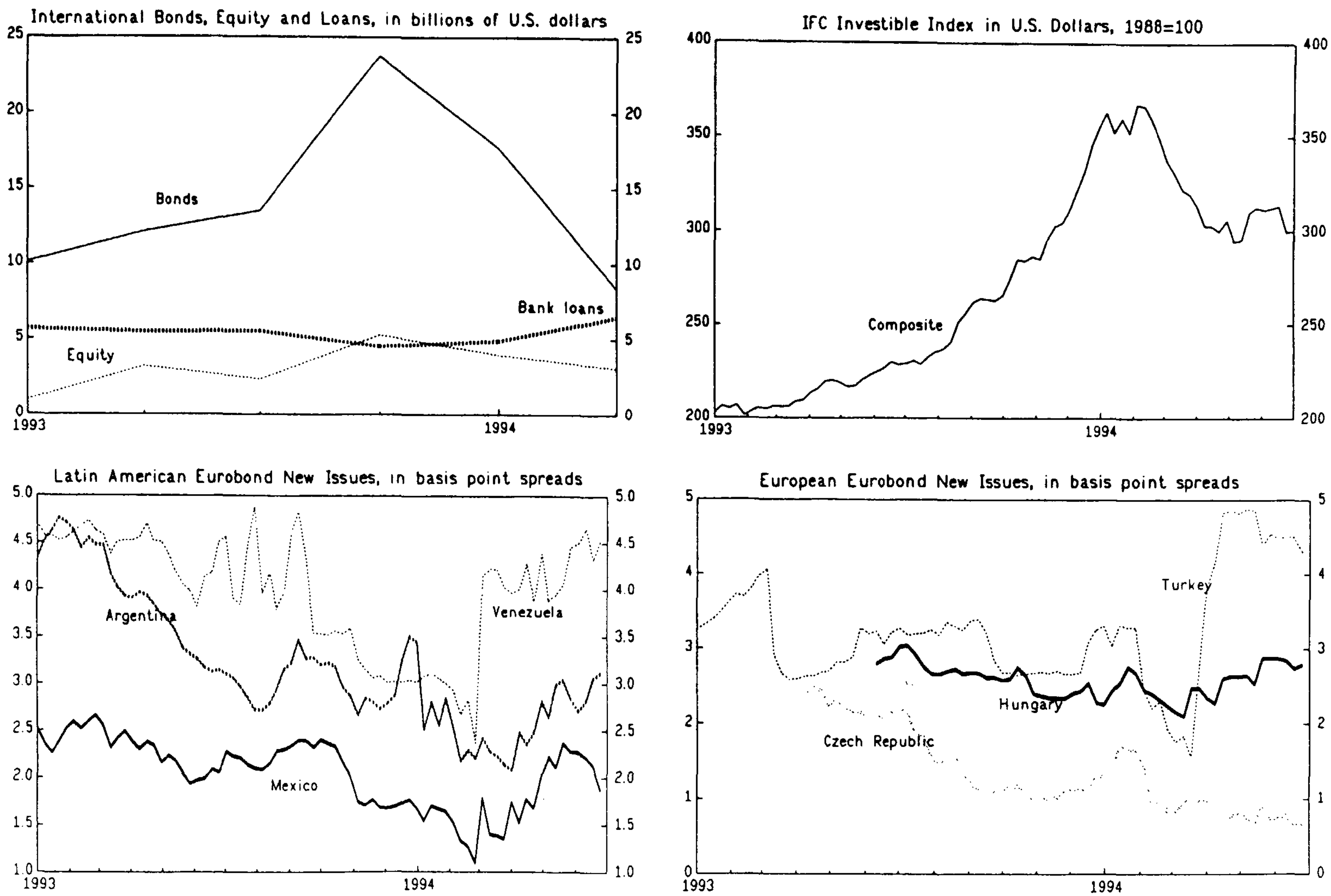
The expansion of the investor base in 1993 was part of the trend towards globalization of investor portfolios. The relative stability of that base so far in 1994, despite the market correction, has been encouraging. As new investor groups come into the market, flows and prices of developing country securities could be subject to considerable volatility, especially if the new investors have poorer information and different liquidity preferences and time horizons than existing investors. A number of developing countries have experienced increased equity price volatility following the opening of local stock markets to foreign investors. 2/ Nonetheless, a diversified and stable investor base can be expected over time to promote smaller fluctuations in asset prices, particularly as information becomes more widely disseminated.

1/ The 1992 market correction is described in M. Goldstein, et al., International Capital Markets Part II. Systemic Issues in International Finance (IMF World Economic and Financial Surveys Series, August 1993).

2/ These points are discussed in Chapter III of the background paper on private market financing.

CHART 6

INDICATORS OF FINANCING FLOWS TO DEVELOPING COUNTRIES, January 1993-June 1994



Sources: International Financing Review, IFC, OECD; and Reuters.

The sharp runup in developing country securities' prices in late 1993 and early 1994 raises questions about the pricing of risk. It appears that the market ranks countries in a manner that is broadly consistent with their recent economic performance and their prospects; however, it is unclear whether investors differentiate carefully among the different borrowers. In general, issuers from countries that previously rescheduled debt tend to pay higher spreads, while those from countries with stronger growth and better inflation performance tend to pay lower ones, as would be expected. But beyond such broad differentiations, the market may be slow to make finer distinctions among borrowing countries. For example, yield spreads on bonds of countries that ran into difficulties in late 1993 were slow to react to the deterioration in their economic performance until it was widely recognized; at that point the response was quite sizable. Investors also have been attracted to developing country securities because asset returns in these markets historically have not closely tracked price developments in industrial country financial markets. The relationship between asset returns in these markets suggests that diversification into developing country securities can potentially raise the expected return on a portfolio for a given level of risk. However, developments during the recent market turbulence suggest that in such periods asset returns tend to become more closely related. 1/

To maintain market access on reasonable terms, countries need consistently to implement strong macroeconomic and structural policy programs. Maintenance of such programs will be particularly important in the period ahead, given a high degree of uncertainty with regard to interest rate movements in the industrial countries. Developing countries also are now entering a period of rising debt amortization as the bullet repayments on bonds issued earlier this decade are beginning to fall due (Chart 7).

Increasing integration of international financial markets means that interest rates and equity prices in developing countries will become more sensitive to developments in asset prices in the major industrial countries. This more open international environment will have to be taken into consideration by developing countries in determining the appropriate stances of monetary, fiscal, and exchange rate policies. 2/ While at times it might appear tempting to supplement these policies with capital controls, such actions in the end would tend to be counterproductive. The volatility in portfolio flows also points to the need for continued efforts to enhance financial markets in developing countries. Structural reforms to increase market transparency and to reduce transactions costs and risks are important for fostering investor confidence. Intermediation of capital flows through the domestic banking system also points to the need for adequate bank regulation and supervision.

1/ See Chapter III of the background paper on private market financing.

2/ The policy issues raised by surges in capital inflows are discussed fully in Schadler, S., et. al. Recent Experiences with Surges in Capital Inflows, IMF Occasional Paper, No. 108, December 1993.

Developing countries can improve the mix of external financing by taking steps to remove obstacles to nondebt creating flows. In recent years, international equity placements and direct purchases of equities by foreigners in domestic stock markets have risen sharply. At the same time, there has also been a surge in foreign direct investment inflows. These flows generally entail a longer-term commitment on the part of the foreign investor. Nevertheless, foreign direct investment flows, taking into account reinvested and repatriated earnings, also exhibit some of the same characteristics as other flows during periods of domestic macroeconomic instability. While investment positions are rarely rapidly liquidated, the totality of transactions associated with foreign direct investments may give rise to net outflows of funds. 1/

Private debt flows to developing countries have primarily taken the form of bonds issued in international markets in the recent past. Investors' preference for debt in this form in part reflects the perceived seniority of bonds to other forms of debt, based on experiences during the debt crisis of the 1980s. 2/ However, bonds were a relatively small portion of total indebtedness during that episode. As their share in total debt rises, the perception of bond seniority may be called into question, and bond yields could rise as a result. Borrowing country governments also should not take too much comfort from the fact that private sector issuers account for a substantial portion of new bond placements. During the debt crisis of the 1980s, governments in several debtor countries ended up guaranteeing private sector debt or subsidizing private debt service. Careful monitoring by the authorities of external debt flows to both the private and public sector is essential so that timely information on the external account can be maintained for the purpose of assessing the appropriateness of macroeconomic policies. The impact of delays in payments on bonds would depend importantly on the issuer and the origin of the delays, 3/ but such developments should be a matter of concern for the authorities owing to potential effects on other borrowers, especially in developing countries that have only recently recovered access to

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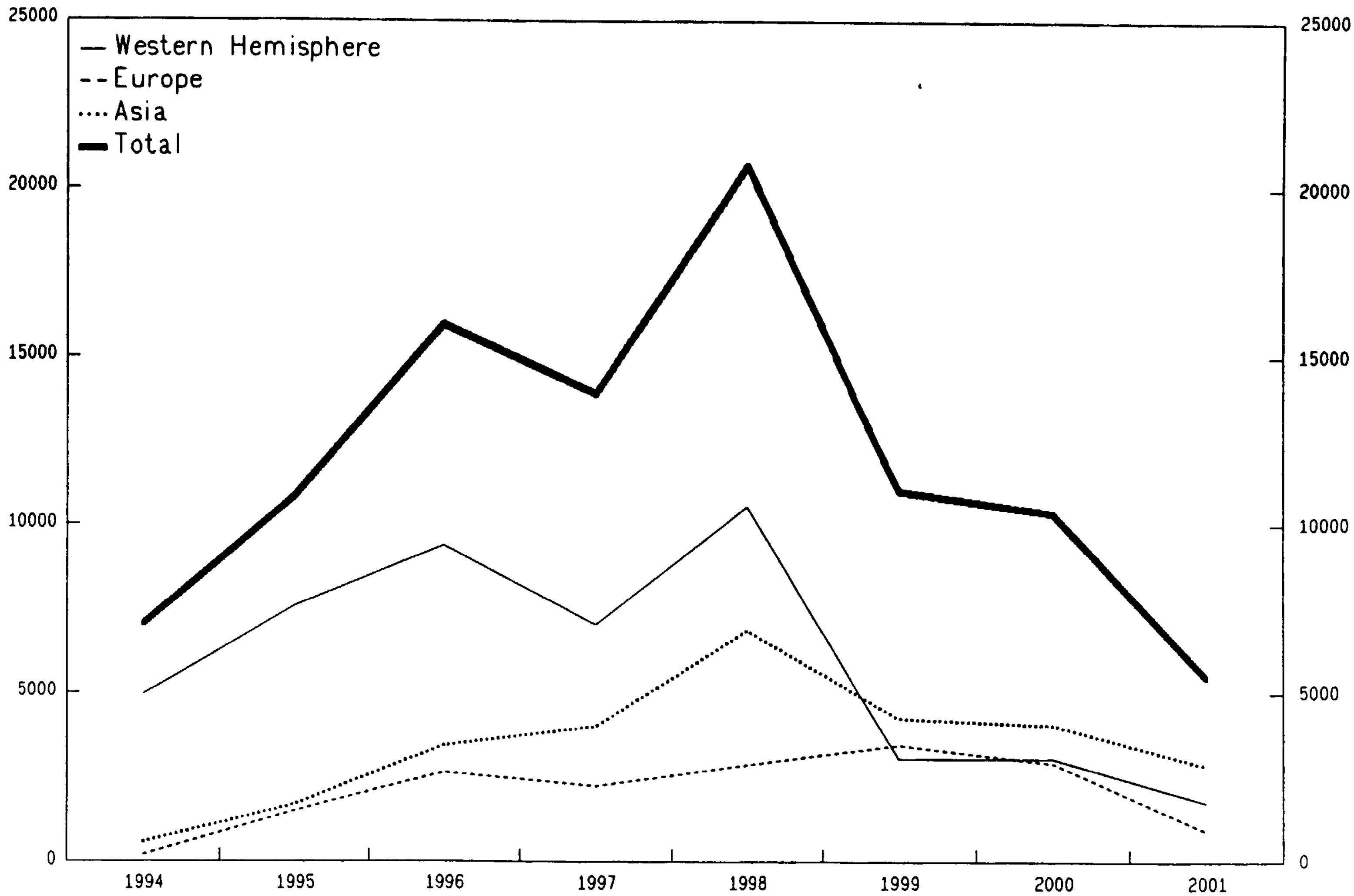
1/ The behavior of foreign direct investment and associated flows is examined in Chapter V of the background paper on private market financing.

2/ Generally throughout the 1980s, countries continued to service their bonds. In the few cases where difficulties arose, they were resolved by rescheduling the bonds. See Chapter VI of the background paper on private market financing.

3/ For instance, payment difficulties on a bond issued by a small private corporation which were related to commercial risk would be expected to have only a small impact on other debtors, as opposed to the effects that difficulties encountered by a major private corporation or financial institution or a public sector entity would have.

CHART 7

MATURING BONDS OF DEVELOPING COUNTRIES,
June 1994-December 2001
(In millions of U.S. dollars)



Sources: International Financial Review, EuroWeek; and staff estimates.

international capital markets. Historical experience suggests that the process of working out payment difficulties on bonds can be very time consuming and potentially very costly for the debtor. 1/ In addition, the spillover effects of one developing country's difficulties on others can be quite substantial. 2/

V. Official Financing

While an increasing number of developing countries have regained access to a wide range of private market financing, countries with more limited market access continue to rely on official bilateral and multilateral creditors and donors for the bulk of their financing needs. For middle-income countries, official bilateral creditors have provided financing in the form of officially supported export credits, and these countries could broaden their market access with sustained implementation of sound policies. Many of the low-income countries, however, remain dependent on grants and highly concessional loans from official sources. Two aspects of official financing are of particular interest at this juncture: (i) the role and potential of officially supported export credits, and (ii) issues arising with respect to debt to multilateral institutions.

1. Official bilateral financing

An important feature of recent developments in bilateral financing has been the substantial increase in export credits to a number of countries, including to economies in transition. But not all countries have benefitted from this rise. For many, in particular the low-income countries, bilateral aid, concessional reschedulings, and multilateral financing remain essentially the only form of external support available. 3/ The increasing budgetary strains in most donor and creditor countries are becoming evident. Bilateral ODA flows have declined during the past year

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1/ See Chapter VI of the background paper on private market financing.

2/ During the recent market turbulence, the yields on bonds became very highly correlated among developing countries, compared with the two years preceding this episode. For details, please see Chapter III of the background paper on private market financing.

3/ The variety of instruments of official bilateral financial assistance and the increasingly complex interlinkages continue to raise serious difficulties for assessing official bilateral flows to developing countries: debt reductions have blurred the previously clear distinction between direct concessional assistance and debt reschedulings; a considerable share of ODA flows remains tied directly to donors' exports; and the increasing diversity of instruments employed in supporting financial flows funded by the private sector make it often difficult to separate official from private financing. These issues are described in more detail in Annex II of the background paper on "Officially Supported Export Credits--Developments and Prospects."

and many donors are re-examining the efficiency of aid allocations. The budgetary costs of the activities of export credit agencies have also come under closer examination in recent years, with a greater focus on creditworthiness. This has led to closer links between the provision of financial assistance and the economic and financial performance of the recipient countries, and these links are likely to be reinforced further in the coming years. Policy performance is thus rapidly becoming the single most important determinant of countries' access to financing from all sources.

On a net basis, bilateral disbursements to all developing countries declined in 1993 by 12 percent to US$43.6 billion, from US$49.5 billion in 1992 with disbursements to low-income countries declining by a slightly smaller percentage, according to preliminary estimates of the OECD's Development Assistance Committee Secretariat. 1/ Bilateral ODA, which constitutes more than four fifths of net bilateral disbursements, declined by around 9 percent. In real terms, total net ODA flows (including contributions to multilaterals) declined by 8 percent, the first decline in four years. In consequence, overall ODA declined from 0.33 percent of GNP of DAC members in 1992 to 0.29 percent in 1993, the lowest level since 1973.

The sharp decline in net ODA disbursements--which wholly reflects the decline in bilateral net ODA--follows the drop in net ODA commitments reported in 1992 due to budgetary constraints in donor countries. ODA flows in 1993 were also affected by a number of special factors such as lower demand for emergency and relief assistance, fewer concessional debt reschedulings by Paris Club creditors and no further large bilateral debt forgiveness initiatives. 2/ However, in 1994, six concessional rescheduling agreements have already been concluded in the first seven months of the year, five of which were for CFA Franc countries following the January devaluation. Also in this context, France has announced debt forgiveness totalling around US$3 billion to CFA Franc countries. Despite the special factors affecting the 1993 results, it would be unrealistic to expect an early reversal of the decline in ODA, given the continuing budgetary pressures in major donor countries. This implies that developing countries, including low-income countries, will need to continue to strengthen their efforts to improve the effectiveness of the use of the aid they do receive, and to attract resources that require a clear commitment to policy reform.

1/ These OECD data exclude officially supported export credits.

2/ Concessional debt reschedulings are included in ODA figures compiled by the OECD.

2. Issues in export credit financing 1/

Export credit agencies have been playing a critical and increasingly prominent role in financing for developing countries. Between 1988 and 1993, new export credit commitments nearly tripled from US$24 billion to nearly US$70 billion, and the total exposure by export credit agencies has increased sharply to an estimated US$380 billion at end-1993, well above the total exposure of multilateral institutions. The driving force behind the increases in activity has been more aggressive export promotion by many governments, which reinforced the resurgence of demand for investment goods in a wide range of countries, including countries that have successfully dealt with their debt-servicing difficulties.

These trends are likely to continue and officially supported export credits will remain a key source of financing for developing countries, and particularly economies in transition. More extensive reliance by official bilateral creditors on export credits as an instrument of financial support raises a number of issues regarding the role and limitations of export credit financing. These will need to be addressed to enhance the effectiveness of export credits and avoid the mistakes of the recent past.

The primary objective of export credit agencies remains the promotion of national exports through insurance or direct extension of credits that are not available from private markets. 2/ Export credits are thus a potentially more stable source of financing than private creditors. In particular, agencies have extended substantial credits to rescheduling countries that established a solid track record of performance under their Paris Club rescheduling agreements, but remain very cautious in extending cover to rescheduling countries with mixed records of performance. This strong emphasis on payments records means that most agencies remain slow in re-opening cover for countries that had poor records in the past but that have more recently strengthened their policies in the context of Fund-supported adjustment programs.

Access to officially supported export credits remains for many countries a crucial step toward establishing creditworthiness and thus access to a wider spectrum of external finance. Moreover, once a more diversified financing strategy has taken hold, official support for export credits can help secure credits for imports of investment goods and for

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1/ The background paper on "Officially Supported Export Credits--Developments and Prospects" reports in detail on the findings of the recent staff mission to export credit agencies and their government authorities.

2/ A notable exception is the Export-Import Bank of Japan (JEXIM) whose operations have over the past years been directed increasingly toward other forms of financing, including untied lending.

projects on terms that often remain unavailable from private sources without the involvement of official creditors, even for countries with investment grade credit ratings. Officially supported credits are therefore an essential component in the financing strategies of most developing countries.

In attempting to improve the quality of their risk portfolios, agencies have become particularly keen on providing export credit cover to countries they consider low-risk markets, and they compete vigorously in such markets. This has resulted in the continued extensive use of tied-aid (or "mixed") credits as an instrument of competition, particularly in some major Asian markets. The recently intensified consultation process within the OECD is expected to reduce over time the scope for subsidization. This could free scarce aid resources for the poorest countries, and free exporters to compete on the basis of quality and price of their products rather than the terms of the associated financing.

The nature of export credit finance imposes limits on the role agencies can be expected to play in the overall financing of developing countries, and particularly countries that require large net financing for prolonged periods. Export credits are linked to new imports of specific products and are expected to be repaid relatively quickly. This suggests that such credits are generally not well suited to substitute for general balance of payments support and should not be relied on as the major source of net financing for prolonged periods. As experience has demonstrated, countries that use export credits for the bulk of their financing needs without diversification towards other sources of financing are likely to run into debt-servicing difficulties which, in turn, require Paris Club reschedulings--at a considerable cost in terms of creditworthiness. Agencies recognize that they need to guard against their tendency to stay on cover for too long in countries that do not have apparent debt-servicing difficulties but are pursuing policies that could lead to future debt problems. However, discipline on their side is complicated by the fact that early warning signals, if available, are usually not conclusive, and the need to ensure that agencies as a group move gradually so as to avoid precipitating a liquidity crisis for the borrower.

Agencies are also faced with strong pressures to extend export credit cover to help exporters gain an early foothold in countries seen as future growth markets such as many of the economies in transition. In these cases, export credits have at times also been used as a channel for significant financial support even though country risk assessment indicated the need for a much more cautious stance, and support was often provided on inappropriately short maturities or for exports that were not competitive in world markets. In such circumstances, agencies could make more intensive use of their recent innovations in risk management. These include more open discussions with debtor countries on how export credits could be used most effectively in cases where cover is limited; the establishment of credit facilities for a wide range of goods and on appropriate maturities; careful project selection; and closer collaboration with other agencies and multilateral institutions (for cofinancing). A strong link to appropriate debtor country policies, however, remains the most important factor in improving the quality of agencies' portfolios, and the quality of financial support.

In cases where they would otherwise not consider support, agencies have sought to establish security arrangements in the form of offshore escrow accounts. Indeed, a substantial number of agencies saw no possibility for providing export credit cover without security arrangements for many developing countries, including in particular the FSU states. 1/ To allow the establishment of security arrangements, including escrow accounts, for the financing of public sector investments, the World Bank adopted in March of last year a change in its negative pledge clause policy to permit waivers of the clause in certain circumstances. General waivers are granted only on a very restrictive basis as regards country eligibility with the principal focus on transition economies that are implementing effective reform programs, making adequate progress in privatization and moving toward a market economy. The waivers are country-specific and limited to projects generating incremental foreign exchange resources. 2/ To date, waivers have been granted for Kazakhstan, the Russian Federation, and Uzbekistan. Escrow-secured lending has not yet become a major element in the financing of these economies largely because of resistance by the debtor country governments to authorize the setting-up of escrow arrangements, though some large deals have recently been concluded on this basis. 3/

Escrow-secured financing has the potential to generate additional foreign exchange, provided that it is targeted closely toward the rehabilitation of enterprises in the export sectors and the development of new sources of exports. These potential benefits need to be weighed, however, against the costs of escrow accounts in reducing flexibility in mobilizing and managing foreign exchange. The caution of governments in acceding to demands for securitization arrangements is therefore well founded. Governments will have to guard against a proliferation of escrow accounts in a manner that encumbers a large part of foreign exchange earnings; they will also need take into account the danger that extensive reliance on securitization packages could reduce access to non-securitized

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1/ In a number of creditor countries, the direct or indirect budgetary costs of export credits (through provisioning) are directly linked to country credit ratings. The use of escrow accounts thus lowers the immediate budgetary impact of export credit support.

2/ For details, see Chapter IV of the background paper on officially supported export credits.

3/ The export credit agencies of Italy, Japan, and the United States have reached agreements with Russia on financing packages totalling some US$7 billion for the oil and gas sectors, to be secured by exports channelled through off-shore escrow accounts. Disbursements from these financing packages are expected to be made over several years. Further deals are under discussion.

Table 8. Structure of Multilateral Debt for Selected Developing Countries

(Multilateral debt on concessional terms as a percent of total multilateral debt outstanding to country group concerned)

	1984	1993 1/
Low-income rescheduling countries 2/	45	74
Severely indebted low-income countries 3/	50	73
Developing countries	29	36

Source: Fund staff estimates.

1/ Preliminary estimates.
2/ For countries covered, see Table 4.
3/ For countries covered, see background paper on official financing (Annex, Section II).

As discussed in Chapter II and shown in Table 6 and Chart 3, debt reduction by private creditors and by official bilateral creditors along the lines already being contemplated by the Paris Club would leave most low-income rescheduling countries with a much more sustainable overall debt burden. However, in a few cases, debt service to multilateral creditors would remain very high (for example, Bolivia, Honduras, Nicaragua, Uganda and Zambia all have in 1994 multilateral debt service at or exceeding 20 percent of exports of goods and services) (Table 5). Finally, with respect to new flows, multilateral institutions have been providing large and positive transfers to low-income countries. For 1992 and 1993 combined, disbursements to low-income rescheduling countries as a group from multilaterals (including the Fund), at over US$8 billion, exceeded debt service to multilaterals by over 70 percent (Table 9). Virtually all of the low-income countries have been recipients of net inflows from multilateral institutions. 1/

1/ See background paper on official financing, Chapter IV.

Table 9. Disbursements from Multilateral Institutions (including the Fund) to Selected Developing Countries

(In billions of U.S. dollars except where indicated)

	1984	1990	1991	1992	1993 1/
			All developing countries		
Gross disbursements	23.2	36.1	38.9	35.0	31.3
Debt service	16.8	34.5	36.4	36.7	36.2
Net disbursements	13.5	15.1	17.6	13.4	10.6
Debt service (as a percent of exports of goods and services)	2.4	4.3	4.4	4.1	3.9
			Low-income rescheduling countries 2/		
Gross disbursements	2.3	4.1	4.0	4.1	4.0
Debt service	1.5	2.8	3.0	2.3	2.4
Net disbursements	1.5	2.3	2.3	2.8	2.6
Debt service (as a percent of exports of goods and services)	6.6	10.8	12.2	9.5	9.4

Source: World Bank Debtor Reporting System; and Fund staff estimates.

1/ Preliminary estimates.
2/ For countries covered, see Table 4.

The overall situation regarding the multilaterals should thus, with continued prudence on the part of both the institutions and borrowers, remain manageable. But beyond this and the legal impossibility of debt forgiveness under the Fund's Articles of Agreement, 1/ there are strong reasons of principle and practicality to reject the notion of such forgiveness. Some of the main considerations are outlined briefly below, with special reference to the Fund.

1/ The Fund has no authority to "forgive" outstanding obligations in the General Resources Account. Even its authority to postpone the fulfillment of such obligations is limited and has never been exercised after the Second Amendment, when additional constraints for postponement were introduced. Regarding SAF and ESAF resources, all resources derived from the Special Disbursement Account are presently committed under security and subsidy arrangements. Since ESAF Trust resources are borrowed, there is no authority to reschedule or forgive obligations to the Trust.

• The multilateral institutions--particularly the Fund and the Bank--at the behest of their shareholders have come to play a central role in the support of developing countries in general, and low-income countries in particular. That role consists not only of providing financing but also of providing policy advice and more broadly of helping to establish a framework conducive to financial support from the international community at large. Debt forgiveness would threaten not only the continued provision of new financing from the institutions--and the associated policy advice--but also financing flows from other creditors and donors which are reliant on the policy framework provided by the institutions. Far from being of lasting benefit to the countries directly involved, moves toward debt forgiveness by multilaterals would undermine the centerpiece for their continued support by the international community in general.

• As noted earlier, there are interlinkages at the country level between new financial flows and debt service obligations. Donors, for example in the context of Consultative Groups, are fully informed of countries' debt-service obligations to multilaterals, which are taken into consideration in determining the volume of resources they are willing to provide. A reduction in multilateral debt service payments as a result of debt relief for a particular country may well be reflected in a reduced level of inflows.

• Forgiveness for one or more members, necessarily entailing a loss, would impose direct and continuing financial costs on other members, those in debtor and creditor positions alike.

• Forgiveness would impair the institutions' preferred creditor status, raising issues of evenhandedness of treatment, moral hazard and contagion. All of this would, for the Fund, pose serious dangers to the institution's monetary character and the revolving nature of its resources; this, in turn, could undermine the willingness of members to continue to provide funding through quota increases or, as necessary, lending to the Fund, including for operations such as the ESAF. Similar issues would arise for the institutions that borrow on the market, like the World Bank; moves toward debt forgiveness could reduce creditworthiness and thereby raise the cost of credit to other borrowers, 1/ while calling into question the readiness of creditors to continue to support needed capital increases.

As stressed above, multilateral institutions are playing a central role in providing both finance and advice to developing countries in general and the low-income rescheduling countries in particular. The challenges facing the economies in transition and low-income countries, notably in sub-Saharan Africa, do not suggest that this role is likely to diminish--rather the reverse. For low-income rescheduling countries, in particular, multilaterals have provided increased inflows both on a gross and net basis, increasingly on concessional terms. The higher exposure of these countries to

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1/ If the World Bank had to pay a 50 basis point higher spread, this would impose an additional cost on Bank borrowers of US$500 million a year.

multilaterals is a result of this growing involvement. Not all multilateral institutions, however, have shifted toward concessional lending for the low-income rescheduling countries as have the Fund and World Bank, and this is a question that needs to be considered.

Appropriate instruments are needed to deal with the few cases with significant arrears to multilateral institutions (such as Rights Accumulations Programs in the case of the Fund), and nonconcessional multilateral debt service should be eased through maintaining or augmenting IDA Fifth Dimension-like mechanisms. 1/ Debt relief, however, for countries with relatively high multilateral debt service would jeopardize the ability of multilateral institutions to continue their wider supportive role for all developing countries. This would appear particularly inopportune at a time when these institutions, and particularly the Fund, are being called on to shoulder more of the financing and risks involved in lending to developing countries in general and the transition economies in particular. The focus of concern for multilateral institutions should thus not be on debt relief--which would likely be counterproductive--but rather on ensuring the effectiveness of multilaterals' policy advice and lending in promoting sustained economic growth in low-income countries. In this connection, it is particularly important in the context of bilateral stock-of-debt operations that policy-based lending be strengthened so that countries are well placed to take advantage of potential private sector inflows. To attract such growth generating flows, countries need to have appropriate policies and institutions in place, including a framework to promote private sector development. This implies adoption and sustained implementation of appropriate macroeconomic and structural policies as well as a renewed emphasis on privatization, the development of domestic financial institutions and of the corporate sector.

VI. Concluding Remarks and Issues for Discussion

Executive Directors may wish to comment on the following observations on recent developments and prospects.

1. The significant progress over the past year provides further evidence that the framework for resolving bank debt problems is effective. The flexibility of the menu approach, which allows the specifics of each package to vary according to each country's needs, is a key to the framework's success. But, ultimately, the progress achieved is attributable in large measure to the consistent implementation of sound macroeconomic and structural policies by the debtor countries.

1/ The Fifth Dimension Facility, financed through reflows on past IDA loans, allocates additional IDA resources to adjusting IDA-only countries with outstanding IBRD debt in proportion to their interest payments on that debt; in recent years, close to 100 percent of interest payments have been covered.

2. For the relatively few remaining middle-income countries that still need to complete bank debt operations, progress will require the countries to pursue strong economic policies and creditors to show some additional flexibility in negotiating debt packages. In particular, consideration will need to be given to complications arising from "pre-Brady" speculation, which can raise questions about the relevance of secondary market prices for bank claims, and from significant amounts of debt being held by nonbank investors.

3. Some of the low-income countries have particularly severe debt burdens and very limited resources. The size of their bank debt may be such that simple buybacks are not feasible. Moreover, the price of their bank claims in the secondary market may not be reflective of the country's debt-servicing capacity. Given these circumstances, resolution of their bank debt problems may entail steeper discounts for debt buybacks and debt exchanges involving limited collateral (to lower upfront costs) and terms based more explicitly on an assessment of the debt servicing capacity of these countries.

4. It will be especially important to ensure that sufficient resources on appropriate terms are available for the low-income countries to help support the cost of bank debt operations. Resources from the Debt Reduction Facility for IDA countries will need to be supplemented by additional resources from other sources, as they have been in the past.

5. Spontaneous private financing to developing countries experienced a sustained expansion between 1990 and 1993, as the strong policies in most issuing countries created good investment opportunities and the investor base broadened. While the sharp correction in early 1994 clouds the short-term outlook for these flows, it would appear that there are grounds for optimism about their sustainability, although they are likely to remain subject to strong fluctuations.

6. The developing countries should continue to strive to reap the benefits of growing integration with international capital markets, while adapting their macroeconomic and structural policies to minimize the effects of fluctuations in capital inflows. It will be particularly important for recipient countries to maintain a strong policy stance over the coming years, because of the sensitivity of flows to the course of international interest rates and the rising amortization on bonds issued earlier this decade.

7. Bonds have become the principal means of debt financing for developing countries, reflecting the perceived seniority of these securities; nevertheless, situations may arise in which this perception may be questioned. While a substantial portion of new bond issues has been placed by the private sector in these countries, careful government monitoring of all external borrowing remains essential. In the event of significant delays in payments on bonds, the impact would vary depending on the issuer and the origin of the delays. But historical experience suggests that the process of working out such difficulties can be very time consuming and costly for the debtor. Moreover, the evidence also indicates that difficulties in one country could easily spill over into others.

8. Progress continues to be made in resolving the debt difficulties of countries mainly indebted to official bilateral creditors. Most of the middle-income rescheduling countries, including some in lower middle-income range, have now graduated from the Paris Club rescheduling process or can be expected to do so at the end of their current consolidation periods. Debt problems remain, however, very difficult for the low-income rescheduling countries. The phased approach to debt restructuring established by the Paris Club three years ago has allowed creditors to deal flexibly with the difficult financing situations of a number of countries that recently reinforced their adjustment efforts. For countries that have already made significant progress under Fund-supported programs, however, early debt-stock operations are now clearly appropriate. While important details of stock operations remain to be worked out, these should not obscure the advantages that will follow successful debt-stock operations. A stock operation on the terms currently granted by the Paris Club on a flow basis would reduce debt service on restructurable debt for most low-income countries to very low levels. A number of countries will, however, require substantially deeper reductions by bilateral creditors to bring debt-service profiles to manageable levels, even in the context of ambitious adjustment programs.

9. While definitive action on debt can make an important contribution to the resumption of sustained growth and development in the low-income rescheduling countries, these countries will continue to require large net transfers of resources from abroad to satisfy basic import and development needs, and it is essential that these transfers be provided on highly concessional terms. It is therefore important that the design of exit restructurings not jeopardize direct financial assistance to these countries. At the same time, debtor countries will need to reinforce their efforts aimed at increasing the effectiveness of bilateral aid, bringing savings-investment balances in line with available external financing, and at attracting, over time, non-debt creating private sector flows, including reflows of flight capital.

10. The need for such a strengthening of policy performance has become more urgent in the face of increasing budgetary strains in most donor and creditor countries. The effects of these strains are now becoming evident. Bilateral net ODA flows have declined during the past year, and current commitment levels suggest that it would be unrealistic to expect an early reversal. There remains considerable scope, however, to reduce the use of aid as an instrument of export competition and thus free scarce aid resources for the poorest countries. Moreover, a sharper focus on risk management and creditworthiness considerations in export credit lending could help reduce budgetary costs while, at the same time, reinforce debtor countries' incentives to adopt and implement appropriate policies.

11. Since officially supported export credits are likely to remain a key source of official bilateral assistance particularly for economies in transition, the limitations of such financing for countries that require significant net financial flows for prolonged periods should be recognized. Some official bilateral creditors have sought special security arrangements in the form of off-shore escrow accounts in cases where they would otherwise

not consider support and where the immediate budgetary impact of new lending is high. While these arrangements can help generate additional foreign exchange if the financing is closely targeted toward productive investments in the export sector, the potential benefits need to be carefully weighed against the danger of proliferation and consequent reduced access to non-securitized lending over an extended period. A proliferation of escrow accounts would also raise serious concerns for the Fund and other multilateral institutions at a time when they are being called on to provide a growing share of the financing for these countries.

12. As bilateral and private creditors are concentrating their lending activities on countries perceived as creditworthy, issues related to the role of multilateral institutions in the financing for developing countries have become the focus of increasing attention. Large net financing, particularly to the low-income countries, has led to a significant rise in the share of debt owed to multilateral institutions. Debt-service payments have remained broadly unchanged, however, as the result of a pronounced shift towards lending on highly concessional terms by the Fund and the Bank. While multilateral debt service is relatively high for a few countries, moves toward debt forgiveness by the institutions would be inappropriate and, indeed, counterproductive. There is, however, a need for certain regional multilateral institutions to ensure that their lending to low-income countries is provided on appropriately concessional terms and with appropriate policy conditionality. The challenges facing the economies in transition and the low-income countries suggest that the role of multilateral institutions is likely to increase, and this underscores the importance of ensuring the effectiveness of multilateral lending and policy advice to promote sustained economic growth and development.