Remarks by M. Camdessus
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before the
Institute of International Finance
Washington, D.C., May 22, 1987

Managing the Debt Problem--Next Steps

I am pleased to join you today and to have the opportunity to reflect on a number of issues that both you as bankers and we in the Fund face when addressing the problem of external indebtedness in the developing countries.

The collaborative debt strategy on which the international community embarked in 1982 has achieved much, not least in averting widespread disruption to the world's financial system. Deep problems, however, remain. And, in the recent period, implementation of the strategy has not always been adequate to meet the very substantial additional strains to which it has been subjected. All this has led to some despondency and to increased interest in "legislated" approaches to dealing with the debt problem. I believe that the former can be overdone and that the latter too often reflects an element of wishful thinking.

In my remarks this afternoon, I want first to examine a number of recent influences on the debt situation and to consider their implications for our current approach. I shall then turn to how the debt strategy needs to be strengthened and, in this connection, will have a few words to say on the role of the banks. I shall have some comments in this context on the recent decision by Citicorp to add substantially to its loan-loss reserves. My focus will be mainly on the middle-income developing countries--and particularly the 15 heavily indebted countries that were identified in the U.S. debt initiative of October 1985--since it is these countries that are in the forefront of your concerns as bankers.

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As you well know, the task of dealing with the debt problem has been complicated in the recent period by a number of adverse developments. Commodity prices have fallen and the terms of trade of the indebted countries have weakened sharply. Net private international lending to developing countries has come to a virtual halt. And there have been difficulties in some countries in sustaining growth-oriented adjustment programs. The consequences have been telling, particularly for the heavily indebted countries. In these countries last year, the current account moved back into deficit; the burden of servicing debt rose; reserves had to be drawn down; and the needed recovery in domestic investment was again held back.

What this means is that it will take longer to resolve the debt problem than had been hoped in the light of the progress made in 1982-84. What it does not mean is that the collaborative approach should be abandoned. Events in recent days do not alter this judgment. The recent setbacks are not insurmountable. And they do not invalidate our objective, which is to restore normal debtor-creditor relations.

Let us look first, in this connection, at adjustment efforts. While there have been important instances of policy slippage, it would be wrong to overstate their incidence and conclude that there has been a general slackening in the will to adjust. Adjustment continues to proceed in many countries. Indeed it has been intensified in a good number of cases in the face of the exceptional difficulties posed by an adverse external environment. One reflection of this is the fact that the decline in the aggregate trade surplus of developing countries last year was limited to less than two fifths of the very considerable loss--of about US$100 billion--in their terms of trade. Developments since the turn of the year have, moreover, given us reason to look for stronger adjustment efforts to be made in the period ahead by a number of countries in which there have recently been policy slippages.

As regards the external environment, worsening terms of trade, relatively high real interest rates and slower world economic growth are, I regret to say, likely to continue to face developing countries in the near term. Recently, moreover, exchange rates have remained unstable and nominal interest rates on U.S. dollar instruments have begun to rise. But the fall in commodity prices in dollar terms appears to have run its course. This means that the weakening in the heavily indebted countries' terms of trade should moderate considerably this year and debt service ratios should begin to subside. In turn, this should permit more of the growth in real income in these countries--which is forecast to remain in excess of 3 percent--to be channeled to domestic investment.

Finally, there is the matter of the availability of bank credit to the indebted countries. I shall have more to say on this shortly. For now, let me simply note the completion late last month of the financing package for Mexico and the first major disbursement of funds under that package.

The point that I would emphasize is that an amelioration of previously negative tendencies in each of these areas would strengthen the ability of the indebted countries to undertake productive investment, to exploit more fully their undoubted economic potential, and to grow gradually out of their debt-servicing burdens. This, in my view, is the approach that will most fully and most assuredly meet the interests of both debtors and creditors--by progressively restoring creditworthiness and promoting sustained economic development for the former; and by steadily strengthening the value of existing loan claims and reopening lending opportunities for the latter.

The way forward is thus, to my mind, clear. All parties to the debt strategy must recognize their responsibilities and intensify their efforts. The indebted countries must be more tenacious in the implementation of measures to mobilize and retain domestic savings, to improve the efficiency with which resources are used, and to strengthen export capacity. This is fundamental. On their part, the industrial countries must do more to foster a favorable global economic environment, with stable financial conditions and better access for debtor countries to expanding markets. Growth-oriented adjustment is needed as urgently in the developed as in the developing world. And creditors must provide adequate financing, in timely fashion and on appropriate terms, to support strong programs of adjustment. It is new impetus, not a recasting, that the collaborative debt strategy needs.

Allow me to elaborate on the matter of financing flows. As you know, lending by the multilateral development banks has been increasing broadly in line with the amounts envisioned in the U.S. debt initiative. In particular, World Bank lending to the heavily indebted countries increased by about one fourth last year, and loan commitments by the World Bank and the Inter-American Development Bank combined were nearly 40 percent above the 1985 level.

The Fund is continuing and will continue to play an active role in assisting countries in the formulation of adjustment programs and in making available its own resources to support those programs. The magnitude of repayments to the Fund in recent months has led to a concern that the institution is systematically reducing its provision of financial assistance to countries in need. This is not so. Repayments are a normal business phenomenon. At present they mirror the very substantial assistance provided by the Fund during the early days of the debt crisis, for the Fund usually lends on a three- to five-year repayment basis. In some cases, they flow from countries that are succeeding in putting their affairs in order and no longer have need to draw on the Fund's resources. In <u>all</u> cases, they re-establish the Fund's potential as a cooperative institution to provide further assistance to its members on a revolving basis. Indeed, despite the reduced need of some countries to make use of the Fund's resources, purchases continue to be at a high level.

But I would be less than frank if I did not admit to you, on a personal basis, that I am dissatisfied to find that the Fund is withdrawing resources from its African members on a net basis at a time when they are facing the most grave economic problems. This is simply not defensible. At a time when the growth of their export markets is less than had been expected, when their terms of trade are continuing to deteriorate, and when interest rates have recently risen, these countries are placed in an extremely difficult situation. As Managing Director of the Fund, I have a responsibility to seek to correct this situation, which I would note touches on the poorer countries beyond Africa as well. I confess that I personally have been most disappointed by the failure so far to obtain additional resources for the Fund's Structural Adjustment Facility, which lends on concessional terms to the poorest countries. You may be assured that we will continue to seek to mobilize additional resources for this facility and, more generally, that the Fund does not intend to withdraw from its role in promoting sound programs of adjustment with growth.

Nor must you, the commercial banks.

Yet, lending by banks to countries with recent debt-servicing problems has been negative in each of the past two years. And, notwithstanding the disbursement last month to Mexico, there is a distinct probability that the first two years following the announcement of the U.S. Government's debt initiative will pass without there being any net lending of significance to the heavily indebted countries overall.

I can understand some of the concerns that have led to these developments. I also recognize that the data are influenced by a number of specific instances in which debtor-creditor relations have been unexpectedly difficult. But I am troubled by the extent of banks' retrenchment and am led to ask three questions.

The first is whether developing countries have now come to be regarded, prima facie, as a poor risk. If they have, it would be regrettable. Developing countries can surely, with appropriate flanking policies, find extremely productive use for new capital investment. And effective lending requires more, not less, selectivity on a case-by-case basis.

The second is whether the reluctance of many banks to increase their sovereign loan exposure does not send the wrong signal to the indebted countries. Does it not risk undermining the latter's resolve to pursue strong growth-oriented reform programs? Does it not, by the same token, risk strengthening the hands of those who would favor a unilateral approach to dealing with debt?

The third question is whether the banking community serves the interests of its customers in the industrial countries by withdrawing from the provision of new financing to the developing world. There is an obvious link between the import capability of the developing countries and production prospects in the industrial countries; indeed, developing countries now provide the market for fully one third of industrial countries' exports. And with the growth in demand in the industrial world itself tending to slow, this link tends to acquire more significance.

These are questions that I would ask you to ponder. There is, perhaps, a fourth question which you would put to me. This concerns the implications of this week's decision by Citicorp for the debt strategy. Let me say first that I regard this decision as representing a judgment by the management of Citicorp on the most appropriate way of buttressing that institution's underlying financial position. What is important from the standpoint of the international debt problem is that Citicorp--and other banks, too--continue to stand ready to provide financial assistance, in appropriate amounts and on appropriate terms, to countries undertaking strong programs of economic adjustment. As you will be aware, Citicorp has made it known that its commitment of support for the debt strategy is unaffected and that it will indeed continue to participate in new money packages so long as the programs are adequately strong. This is an important declaration, which is to be welcomed. Recent events could, of course, through market processes have consequences for the attitudes of other banks. This remains to be seen. At this time, I would only emphasize the very great importance of there being no loss of cohesion within the banking community as a whole in <u>its</u> support for the collaborative debt strategy.

Indeed, in current circumstances, net lending by banks, at a moderate pace, to support the process of adjustment and structural reform in middle-income countries is sorely needed. The immediate challenge, in this context, is to overcome the protracted delays that have attended the assembly of recent financing packages. At the heart of these delays have been issues of burden sharing between individual banks and among national banking systems, which in turn have often reflected strong competitive pressures, differing exposures, and disparities in tax and regulatory arrangements. These, obviously, are matters for the banking community to resolve, with the help of their regulatory authorities. Arrangements that allow participating banks a wider range of financing options are clearly one avenue. Such schemes as the conversion of debt to equity or domestic loan claims are a case in point. They need, of course, to be carefully designed so as to guard against an unintended reduction of resources available to the debtor country. This said, I have been encouraged recently by a number of judicious innovations in this area, particularly in the most recent financing package for Argentina. It is a process which needs urgently to be built on and which could, perhaps, be nurtured by banks' supervisory authorities.

Insofar as the Fund can help to expedite the organization of concerted lending, it will. The key issue, after all, is whether the international financial community has the resolve and the imagination to work collaboratively with troubled borrowers over what will be an extended period in order to rebuild their creditworthiness. There is no instant solution, no magic wand. We all--debtors, banks both large and small, and multilateral institutions--need to work more closely and more effectively to tackle this crucial task.