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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 87/147

10:00 a.m., October 21, 1987

R. D. Erb, Acting Chairman

Executive Directors	Alternate Executive Directors
	S. M. Hassan, Temporary
	Jiang H.
	M. K. Bush
	J. Prader
A. Donoso	
	M. B. Chatah, Temporary
	B. Goos
J. E. Ismael	J. Reddy
A. Kafka	J. Hospedales
	M. Foot
	D. McCormack
	N. Toé, Temporary
Y. A. Nimatallah	I. A. Al-Assaf
	C. Noriega, Temporary
	D. Fogelholm
	D. Marcel
G. A. Posthumus	
	C.-Y. Lim
G. Salehkhou	O. Kabbaj
	A. Vasudevan, Temporary
	M. Sugita
S. Zecchini	

L. Van Houtven, Secretary and Counsellor
S. L. Yeager, Assistant

Also Present

IBRD: J. A. Paz Estenssoro, Latin America and the Caribbean Regional Office. Exchange and Trade Relations Department: E. Brau, H. B. Junz, M. Xafa. External Relations Department: H. P. Puentes. Legal Department: F. P. Gianviti, General Counsel; A. O. Liuksila. Research Department: N. R. Chrimes. Treasurer's Department: F. G. Laske, Treasurer; T. Leddy, Deputy Treasurer; D. Williams, Deputy Treasurer; D. H. Brown, B. B. Zavoico. Western Hemisphere Department: S. T. Beza, Director; M. Caiola, Deputy Director; S. Almuina, J. Ferrán, H. M. Flickenschild, M. E. Hardy, D. S. Hoelscher, J. E. Leimone, J. Sol-Pérez. Advisors to Executive Directors: F. Di Mauro, G. D. Hodgson, P. D. Péroz, G. Pineau, D. C. Templeman. Assistants to Executive Directors: A. R. Abdullatif, A. Badi, V. J. Fernández, M. Hepp, K.-H. Kleine, M. A. Kyhlberg, V. K. Malhotra, T. Morita, L. M. Piantini, D. A. Woodward, H. van der Burg.

1. VOLUNTARY CONTRIBUTION ACCOUNT - ESTABLISHMENT AND ADMINISTRATION FOR BOLIVIA

The Executive Directors considered a staff paper on the establishment of a Voluntary Contribution Account at the request of Bolivia (EBD/87/251, 10/5/87) for the administration of resources to be contributed by other countries to finance the buy-back of a portion of Bolivia's external indebtedness (see also EBS/87/181, 8/19/87).

The Acting Chairman made the following statement:

On October 5 a staff paper (EBD/87/251) was circulated to the Executive Board containing a request by Bolivia that the Fund establish and administer a Voluntary Contribution Account to facilitate a buy-back of Bolivia's commercial bank debt. As this is an unusual operation, I would like to review some of its background.

Bolivia is a heavily indebted, low-income country. Its external public debt is about equal to its annual GDP, and its per capita GDP is the lowest in South America. Following a major reorientation of economic policies in 1985, the country has been undertaking a comprehensive adjustment program with reliance on price incentives and market-oriented policies. This program has been implemented in close collaboration with the Fund. The use of the Fund's resources was approved under a structural adjustment arrangement in December 1986 and is being requested under an extended arrangement in support of a program that extends through the end of 1990. The World Bank and the Inter-American Development Bank also have stepped up support from their concessional facilities. The Paris Club agreement of 1986 provided comprehensive debt relief on most liberal repayment terms then offered, and Bolivia will shortly approach its official bilateral creditors for a further rescheduling.

Bolivia's relationship with the foreign commercial banks is special in several respects. Principal owed to commercial banks, amounting to some $660-670 million, represents less than 20 percent of external public debt. Bolivia has not had recourse to commercial bank loans in the 1980s, and its program through 1990 does not contemplate resumption of such borrowing. Bolivia has not made any payments to the banks since March 1984, and its bank debt is traded at a discount of 85 percent to 90 percent in the secondary market. Nevertheless, Bolivia has continued to make efforts to maintain relations with its commercial bank creditors, who recognize that Bolivia's external payments situation would preclude solutions that increase its external indebtedness on commercial terms. Bolivia's request to establish the Voluntary Contribution Account stems from an agreement reached

during thse negotiations. The proposed buy-back is to proceed on the basis of an amendment of the 1981 Refinancing Agreement that is supported by a unanimous decision of all of Bolivia's bank creditors.

The main characteristics of the proposed buy-back are as follows. First, the buy-back is entirely voluntary. Other countries are free to contribute funds which Bolivia will use to buy back commercial bank debt, but there is no obligation on the commercial banks to participate in the buy-back. Both interested parties--Bolivia and the banks--have requested the good offices of the Fund to ensure that the buy-back will be carried out in the way that was envisaged. To respect the voluntary character of the arrangement, the Fund has remained neutral, bringing no pressure either on individual countries to contribute funds or on banks to participate in the buy-back by tendering their claims at the price offered by Bolivia. Second, the arrangement would enhance Bolivia's external position because all contributions are expected to be donations or loans on very concessional terms, and no use of Bolivia's international reserves is to be permitted other than for the purpose of prefinancing contributions by countries that cannot make the funds committed available during the four-month buy-back period. Third, the buy-back is clearly not a "bailout" of commercial banks by official creditors, since the banks would be selling at a value that would likely be well below the face value.

In deciding to support Bolivia's request to assist it in the establishment of a Voluntary Contribution Account, management concluded that it was consistent with the purposes of the Fund. The arrangement would assist a member country that has been implementing an adjustment program for a period of time with financial support from the Fund in re-establishing its external viability; it was voluntarily agreed upon between the member country and its nonofficial creditors; it would become operative only if other countries are willing to contribute and banks are willing to take advantage of the arrangement; and it would contribute to a restoration of Bolivia's relations with its creditors.

Thus, in our view, this arrangement provides an option for addressing Bolivia's debt to nonofficial creditors that is both realistic and consistent with the overall debt strategy of the case-by-case approach and the restoration of payments relations through direct negotiations between debtors and creditors. The special characteristics of this case indicate that it is not likely to represent an approach that would have general application.

Mr. Donoso made the following statement:

The Acting Chairman's statement exactly describes the special characteristics of the Bolivian request. I wish to emphasize only some points in this regard.

Bolivia is the poorest Latin American country. It is heavily indebted, and it has recently experienced the most devastating losses in its terms of trade. In these difficult circumstances the Bolivian authorities have been implementing a comprehensive adjustment program. Demand management has been forcefully oriented to correct major imbalances. Already, a dramatic reduction in rates of inflation has been achieved. Indeed, Bolivia might have the lowest rate of inflation in Latin America. Major reforms to enhance the role of the market and to orient the economy toward greater integration with the world economy have been successfully introduced. Bolivia is doing its utmost to achieve growth after several years of continuous economic deterioration. Production figures already show positive movement, and a positive rate of growth is now being projected.

Bolivia deserves the full cooperation of the financial community, and in particular, of the Fund. Official and commercial creditors understand that Bolivia needs special treatment to re-establish its external viability, and they have been willing to cooperate with the country to this end. The buy-back is one more important mechanism to enhance Bolivia's external position, together with concessional financing from multilateral institutions and official creditors. The buy-back has been fully supported by Bolivia's commercial creditors. As it is based on the use of donations or concessional loans, the Fund has also found that the buy-back would strengthen Bolivia's external position.

The procedures relating to the administration of the Account were carefully designed. The successful implementation of this initiative requires that the Account be administered by an institution that is both totally reliable and highly technical. Bolivia, potential contributors, and the country's creditors consider that the participation of the Fund in the buy-back operation is essential to its successful outcome.

I thank management for its dedication to this case and the Board for consideration of this matter today. The Bolivian authorities are holding meetings with the country's creditors at this moment in New York, and the result of our meeting is important to those negotiations.

Mr. Noriega remarked that during the last Article IV consultation with Bolivia (EBM/87/197, 12/15/86), he had commended the authorities for their comprehensive stabilization program. As the program supported by a

structural adjustment arrangement with the Fund would be extensively discussed in the coming week, he would emphasize only the importance of Bolivia's restoring normal relations with the international financial community to the ultimate success of its program.

For countries like Bolivia, the sheer size of their debt constituted an obstacle to the normalization of relations with creditor banks, Mr. Noriega added. In that context, the proposed buy-back offered a promising approach to the debt problem, and it deserved the full support of the Fund and potential donors.

It was apparent that the buy-back alone would not solve Bolivia's debt problem, Mr. Noriega commented. Commercial bank debt accounted for only about one fifth of Bolivia's overall debt, and the proportion of debt eventually retired by the buy-back and the outcome of the subsequent restructuring of remaining debt had yet to be seen. It was likely that Bolivia's external account would continue to be somewhat weak in the near future, and that the remaining debt burden would continue to impinge on the sustainability of its adjustment efforts. Furthermore, the Fund had a delicate role to play in the buy-back operations, particularly with respect to the sensitive issue of disclosure of information. He was, nevertheless, convinced of the usefulness of the Fund's role and of the authorities' commitment to their economic and financial program. He therefore supported the proposed decision.

Mr. Nimatallah commented that the Voluntary Contribution Account was a relatively new mechanism, and he would like to know more about its operation. In particular, would it expose the Fund to any unnecessary liabilities? Could a less complicated mechanism achieve the objectives of the proposed Account? Was there a connection between the proposed mechanism and Bolivia's adjustment program? In view of the number of participants in the scheme, how was confidentiality to be maintained? And, what would be the Fund's relationship with participants?

Mr. Posthumus wondered why Bolivia and its creditor banks had asked the Fund to administer the Account. The Fund had remained neutral during the negotiation of the debt buy-back arrangement, and he was concerned that the Fund's administration of the Account might create the impression that the Fund agreed with that arrangement, which was something the Fund should not do.

The staff representative from the Western Hemisphere Department explained that when Bolivia and the Coordinating Committee of the foreign commercial bank creditors had drafted their proposed debt buy-back arrangement in February, they agreed to ask the Fund to confirm that the funds Bolivia intended to use for the buy-back had actually been contributed by other countries, for that specific purpose. At that stage, the establishment of an Account for Bolivia, to be administered by the Fund, had not yet been considered. Subsequently, some banks indicated that their agreement to the buy-back scheme was contingent on the involvement of an

institution like the Fund. Although all banks had agreed unanimously to the arrangement, some banks, which did not wish to see Bolivia's future debt-servicing ability impaired by recourse to its own reserves for the buy-back, proposed that the Fund should receive contributions and effect their disbursement in line with the agreed purpose of the buy-back. The Coordinating Committee and Bolivia had then approached the Fund to see whether it would be willing to assume that enhanced role.

There was a connection between the scheme and Bolivia's adjustment program, the staff representative from the Western Hemisphere Department remarked. As the staff had pointed out during the Board discussion on the stand-by arrangement for Bolivia in June 1986, because of the heavy debt-servicing burden of Bolivia's existing commercial bank debt, it was assumed that Bolivia would receive concessional treatment by the banks to help the country regain external viability. The existing structural adjustment arrangement and any future use of the Fund's general resources in support of Bolivia's adjustment program would explicitly take into account the buy-back. With regard to the buy-back, the Fund would have no contact with individual holders of Bolivia's commercial bank debt, but rather would deal with the Coordinating Agent for the banks, namely, the chair bank of the Coordinating Committee.

Mr. Nimatallah commented that if the banks were willing to agree to debt servicing on concessional terms, it might be better for them to wait until Bolivia's economic situation had improved, thereby increasing the market value of their claims.

The staff representative from the Western Hemisphere Department observed that the banks would in all likelihood have to wait for some time. The staff's medium-term scenario for Bolivia indicated the numerous imponderables regarding the attainment of external viability in the 1990s. Moreover, there were legal reasons for the banks to act at present. Under the statute of limitations of the State of New York, banks must take some action within six years of the emergence of arrears. That six-year period would expire in September 1988. Thus, a legal agreement would have to be reached to extend the statute of limitations for another six years.

The staff representative from the Legal Department, commenting on the Fund's liability arising from the establishment of an Account for Bolivia, remarked that a distinction should be made between the agreement between Bolivia and its creditors regarding the buy-back and the role of the Fund in the operation. The Fund's role was limited under the proposed arrangement: the Fund would first, administer a procedure for verifying that Bolivia's external reserves were not being used for the purposes of the buy-back, except in those instances where there was some prefinancing by Bolivia of aid money that was not likely to be received within the four-month buy-back period. Second, the Fund would establish an Account for receiving monies paid to the Central Bank of Bolivia by contributors and

also monies paid directly to the Account by contributors. Those two tasks were within the ambit of Article V, Section 2(b), which provided legal authority for the Fund to perform services, such as the administration of resources, at the request of a member.

The relationship between the banks and the Fund was also very limited, the staff representative continued. The Fund would be responsible for administering assets held in the Account which were to be deposited by the Fund with either the Bank for International Settlements or the Federal Reserve Bank of New York, and for disbursing funds from that Account upon the instructions from the Central Bank of Bolivia for the buy-back of debt claims from the banks. In that regard, the Fund's role was simply a fiduciary one. In turn, all contacts with the banks regarding the Account would be through the Coordinating Agent, the Bank of America. Shortly after receiving a contribution to the Account the Fund would notify the banks of the restrictive terms and conditions attached to donations and concessional loans, and if the banks objected to the use of a particular contribution, the Bolivian authorities would have to discuss the matter further with the banks. If those discussions were not carried out promptly and did not allow the receipt of the contribution by the Fund, the Instrument provided for the return of monies to the transferor in question.

The Fund's approval of the buy-back scheme as such had not been proposed, the staff representative from the Legal Department observed. The request was only for the Fund's assistance to ensure the proper administration of a financial aspect of the scheme. As stated in the staff paper, "the Fund will not incur any obligation or liability by reason of the establishment, administration, or termination of the Account. The draft Instrument does not create authority for the Fund to undertake financial obligations as administrator of the Account." More specifically, the Account would not borrow or otherwise incur liabilities. Thus, the Fund's liability under the scheme did not go beyond that ordinarily associated with the legal liability that was associated with the adminstration of resources on behalf of a member.

The staff representative from the Exchange and Trade Relations Department emphasized that the buy-back was clearly not a "bailout" for commercial banks. The contributions to the Account for Bolivia were for the purpose of a buy-back only, and, for that reason, were resources that would not be available otherwise.

The size of Bolivia's outstanding debt in itself was an obstacle to the re-establishment of normal relations with commercial banks in the broader sense of the term; thus, any attempt to reduce the stock of debt would be helpful, the staff representative from the Exchange and Trade Relations Department said. In that light and within the overall debt strategy, it would be useful for the Fund to facilitate the re-establishment of normal relations between the authorities and the banks. Specifically, the authorities were concerned that a number of potential donors might want to remain anonymous, while commercial banks

wanted to ensure that no funds other than those donated for the buy-back--particularly funds that otherwise might have gone freely into reserves--would be used for that purpose. For those reasons, the involvement of an outside agency to verify the receipt and disbursement of contributions was considered necessary.

Mr. Nimatallah remarked that his authorities would like to help Bolivia. In that regard, he wished to place three points on record. First, there should be no legal loophole of any sort in the Instrument establishing the Account that would expose the Fund to any kind of liability or indemnification. Second, as the Acting Chairman had mentioned, "the special characteristics of this case indicate that it is not likely to represent an approach that would have general application." Bolivia should indeed represent a special case: banks should not be given an opportunity to put pressure on countries to adopt such schemes. Similar requests would have to be evaluated on a case-by-case basis. Finally, the cumbersome process involved in administering the Account for Bolivia should be simplified.

Mr. Zecchini observed that the buy-back scheme was intended to help normalize Bolivia's relations with its commercial creditors. However, the staff paper indicated that Bolivia did not intend to seek any new borrowing from commercial banks in the next several years. What then was the purpose of the normalization of relations? A second question related to the provision in the agreement that the Central Bank would specify which contributions were to be disbursed and that the Fund would not determine the order in which contributions were used for disbursements, nor advise the Coordinating Agent concerning the further distribution of funds among creditors. Since money was a fungible asset and donations were also supposed to be unconditional, what was the intent of that provision?

The staff representative from the Legal Department, explaining the structure of the Account, remarked that balances paid to the Account would have to be identified and kept traceable because the Instrument provided for the termination of the Account at the request of Bolivia or the Fund, and upon termination some monies might have to be returned to contributors. The Fund's records therefore would reflect the various balances held in the Account, their investment, and the accrued investment income. The Fund thus would know exactly which balances had been used for the buy-back and which balances remained in the Account to be redistributed to contributors in accordance with their instructions, upon termination of the Account.

The procedures were somewhat complex because of the need to receive notifications and certifications with regard to the purpose of funds received and to confirm the terms and conditions under which they would be made available, the staff representative explained. Thus, the regulation was fairly complex; the operation of the Account, however, was meant to be fairly simple.

Regarding Directors' concern that the request should not set a precedent or become generalized, it should be noted that no entitlement was created for members to benefit from the service by the Fund, the staff representative from the Legal Department commented. Any member could request similar services from the Fund under the provisions of Article V, Section 2(b), but in each instance the granting of the request would be at the discretion of the Board. The value of the proposed decision as a precedent was thus greatly reduced.

Mr. Zecchini remarked that he understood from the staff's explanation that if the Account was terminated without fully utilizing available resources, Bolivia could choose to use some contributions and might eventually return unutilized funds to contributors. He wondered whether such a discriminatory procedure was consistent with the Fund's general practices. The Fund--although it was not directly involved in the Account--indirectly had more at stake than that of a simple fiduciary agent.

The staff representative from the Legal Department noted that Bolivia would determine which contributions were used first. If the Account was terminated after all monies were used for the purpose of the buy-back, there would be no discrimination, of course. Indeed, it was not expected that the Account would be terminated before the buy-back was carried out and, therefore, no surplus was expected to be available for distribution to contributors once the buy-back operation was terminated.

Ms. Bush observed that contributors might place different conditions on their contributions which would, to some extent, influence the timing of their disbursement. What restrictions or conditions were envisaged? The staff paper also indicated that creditors might object to the use of certain contributions; what effect would that possibility have on restrictions or conditions applied to contributions?

Mr. Foot wondered whether any aspect of the scheme could result in discrimination against certain banks. For example, could a donor country specify that a certain proportion, or all, of its donation should be used to buy back Bolivian debt held by its own banks?

Mr. Goos commented that the questions raised by Directors were cause for some concern. While it was essential to understand how the Account would function, it would be inappropriate for the Fund to redefine the operations of the Account. The agreement between the creditor banks and Bolivia should be left as agreed, for the reason mentioned by Mr. Posthumus: the Fund's role should be only that of administrator of the Account; it should not be perceived as actively promoting the Account or trying to impose certain ideas on the operation of the Account.

The staff representative from the Legal Department, commenting on the restrictions or conditions that might be applied to contributions and their potential for discrimination, said that those were matters for the banks and the Bolivian authorities to settle among themselves. As for

the Fund, it had noted the agreement on those matters, and the Account provided for notification to the banks regarding the terms and conditions of transfers that were not unconditional; banks might or might not agree to those transfers if they felt that the terms, restrictions, or conditions attached to them were such that, for instance, discrimination against particular banks would result. The staff was not aware of any discriminatory restrictions on the use of particular funds.

The practices of various aid donors suggested that some donations and concessional loans to the Account would be delayed, the staff representative from the Legal Department commented. In the event, the Instrument envisaged the possibility of prefinancing of the amount that was pledged by the Central Bank of Bolivia. In those circumstances, the Fund would inform the banks regarding the terms and conditions of prospective disbursements and the prefinancing involved, and the banks would have to decide whether the likelihood of eventual receipt of the aid donation was so great as to warrant prefinancing by the Central Bank of Bolivia. In sum, the only amounts that could go to the Account unchecked by the banks were those that represented unconditional, unrestricted donations from the contributors.

The Deputy Treasurer remarked that he wished to emphasize the passivity of the Fund's role in the buy-back: the Fund was to confirm, certify, and verify transactions on the Account for Bolivia. The Fund would receive resources from the individual contributors; disburse them to the Coordinating Agent--the Bank of America, National Trust and Savings Association--and keep the financial records of the Account. He agreed with Mr. Nimatallah that the Instrument seemed complicated; the actual operations, however, were neither complicated nor time consuming. The various contributions should be viewed as individual, traceable deposits on behalf of Bolivia, which would determine how the resources were to be used.

Mr. Zecchini said that he fully agreed with the Deputy Treasurer that the Fund played basically a passive role. Nevertheless, he questioned the limits of that passivity; in particular, to what extent was the possibility of discrimination among contributors in line with the spirit of Fund-administered accounts? He did not, however, want to pursue the point any further.

Mr. Donoso observed that the request for establishment of a request for an Account was similar in nature to enhanced surveillance, in that a member requested the Fund to perform a service without the Fund entering into the details of the arrangement between the country and its creditors which prompted the request.

Mr. Zecchini remarked that while he agreed with Mr. Donoso, under enhanced surveillance the Fund was expected to provide an assessment of the member country's adjustment efforts. In that respect, the Fund's assessment was independent of the agreement between the debtor country and its commercial creditors. His question, however, was focused on the limits to the Fund's passivity with respect to such agreements.

Mr. Prader made the following statement:

Our chair has always supported new, imaginative methods of tackling the debt problem. The debt buy-back scheme for Bolivia and, in particular, the Fund's role in the operation of the Voluntary Contribution Account is therefore welcome.

While recognizing the skillful, imaginative design of the scheme and appreciating the willingness of donor countries to contribute concessional funds, we have some questions with respect to its economic effects, the even distribution of the benefits accruing to the parties involved, and the implications for the debt strategy in general. In this connection, the working paper on "Buy-Backs and the Market Valuation of External Debt" (WP/87/58, 9/10/87) has been most helpful in analyzing the issues involved. At first sight, the advantages accruing to Bolivia from this scheme seem to be overwhelmingly positive, above all from the perspective of restoring Bolivia's creditworthiness. But in view of the specific rules governing the operation of the Account, some limitations referred to in that working paper in this case.

More specifically, the main effect of earmarking the proceeds of donors' contributions solely for the buy-back of claims would be an increase in the market value of these claims. Could the staff elaborate on the benefit to the debtor country in terms of investment or income effects? Another problem which might arise relates to the roles of different actors in the debt strategy. One of the main results expected is an improvement in the creditworthiness of Bolivia, but at the same time, no new borrowing from commercial banks is envisaged over the next several years. Thus, Bolivia's adjustment during this period will have to be financed almost exclusively by Fund resources and official aid. The lack of participation in and withdrawal from the debt management process on the part of commercial banks--and this at terms which are, as a result of official intervention in the form of such schemes, more favorable than would be obtained under normal market conditions--is somewhat disquieting. A number of the new debt conversion schemes have ambivalent features, which sometimes serve to remove the pressure on banks to participate in debt management and to maintain their exposure. As a result, an increasing part of the debt and adjustment burden is being shifted to the Fund.

In view of the larger ramifications of the buy-back, I would argue in favor of a more substantive discussion of such schemes in the context of further discussions on the debt strategy. I also share Mr. Nimatallah's view that this special case should not become a precedent for a generalized solution of debt problems.

Another more technical, but nevertheless important, consideration is that, for the scheme to be successful, the amounts of donors' contributions will have to be kept secret. Otherwise, the market value of the banks' claims on Bolivia would be moved too much in favor of the banks. It is therefore reassuring that the need for confidentiality regarding the amounts available for the buy-back is taken into account in the construction of the scheme.

Mr. Marcel made the following statement:

Last year this chair welcomed the strong efforts of the Bolivian authorities to tackle the extremely difficult state of the economy; we commended them for the impressive results they had already achieved. In the course of our discussions, most Directors emphasized that the success of the program depended on a generous response on the part of donors and on generous rescheduling by commercial banks and official creditors. In this context, my authorities are open minded about innovative arrangements to address Bolivia's debt to nonofficial creditors, to the extent that such arrangements are in keeping with the menu approach to the debt strategy.

However, my authorities are concerned about the buy-back of bank debt by Bolivia. The buy-back at a discount does not seem to be in keeping with the debt strategy approach confirmed recently at the Annual Meetings. This kind of arrangement does not appear to be appropriate for several reasons. First, the debt secondary market is very narrow and volatile; consequently, it cannot provide a sound and appropriate basis for substantial operations. Second, the systematic buy-back of bank debt at a discount could lessen governments' desire to adhere to adjustment policies. Furthermore, it could induce debtor countries to take unilateral measures aimed at reducing the value of their debt on the secondary market.

My authorities consider that it is not appropriate that the Fund will participate in the establishment of a Voluntary Contribution Account to facilitate this buy-back scheme. Even indirect involvement could give the impression that this institutuion supports such an innovative approach. In light of the central role that the Fund plays in the development of the debt strategy, and also in the maintenance of a sound international financial system, it is clear that this operation may send the wrong signal to the markets.

Also, a number of creditor countries expressed their reservations about this kind of arrangement at a Paris Club meeting last September. These countries consider in particular that the timing of this proposal is not appropriate and that it therefore presents substantial risks for the implementation of the debt strategy.

In any case, even if this scheme is implemented, I insist strongly that the Bolivian case remain unique, considering the special characteristics of the country. I would stress also that the use of Bolivia's international reserves for the buy-back must be avoided; therefore, we should be assured that Bolivia will buy back only the amount corresponding to the grants and concessional loans from contributing countries.

Furthermore, even if there is no risk of a bailout, my authorities wonder whether this arrangement does not raise some difficulties regarding the comparability of treatment between different categories of creditors. Moreover, it is possible that such a scheme is not likely to assure a perfect balance between the contribution received from one country and the debt bought back from a commercial bank of the same country.

I would like to ask that the staff provide a table summarizing the total amount of contributions and buy-backs for each country as soon as this information is available.

To conclude, in view of all these caveats, France is not in a position to provide any financial contribution for this operation.

Mr. McCormack remarked that his authorities considered that the proposed establishment by the Fund of a Voluntary Contribution Account to help Bolivia buy back its commercial debt was desirable to rectify the debt service situation in Bolivia, which had been extremely difficult. The proposed mechanism appeared to be an effective means of organizing a debt buy-back scheme: it would respect the need for confidentiality, it would ensure that the buy-back was entirely voluntary, and it met the interests of both Bolivia and the banks. Since Bolivia had already implemented an adjustment program supported by an arrangement under the structural adjustment facility, the Fund was a logical choice for establishing such an Account, and his authorities therefore supported the proposed procedure, although with a measure of reluctance and a few questions.

First, it was important that Bolivia's request should not establish a precedent, Mr. McCormack emphasized. Any similar requests by members would need to be examined on a case-by-case basis. Any future Fund role as intermediary should be with the concurrence of both the country and the creditors concerned. The degree of success of the Bolivian initiative would be an important element in determining whether the Fund should play an intermediary role in the future. Second, he wondered what administrative resources were required, and what was the cost of establishing the proposed Account? Third, was the establishment of an Account based on contributions from governments a logical extension of the debt strategy? While the debt buy-back scheme for Bolivia contained elements

of a "market solution," any purchases under that arrangement would be based on resources from governments, which might involve only a reallocation of existing aid resources.

Nevertheless, his authorities recognized that the proposed arrangement might help to reduce Bolivia's debt burden, based on a negotiated market discount, Mr. McCormack continued. The arrangement involved a voluntary choice for commercial banks, and should reinforce the difficult adjustment process taking place in Bolivia. For those reasons, they were prepared to support the proposed decision.

Mr. Foot remarked that the extensive effort by the Bolivian authorities in the past 18 months to deal with the serious problems they had inherited from their predecessors inclined him strongly to support the authorities' request. Although he had some reservations regarding the buy-back scheme, it was reassuring that there would be no undue expense to the Fund in operating the Account; that there were no financial risks for the Fund arising out of the administration of the Account; that the Fund's role was limited and did not involve lobbying potential donors or commercial banks; and, finally, that the Fund was not supporting an arrangement that involved discrimination between donors or banks.

He associated himself with the comments of a number of previous speakers, particularly Mr. Prader and Mr. Marcel, Mr. Foot continued. Like other speakers, he considered that Bolivia's request should be regarded as a special case, and he supported it on the basis of the country's exceptional economic circumstances. However, he would not wish to see such an approach to the debt problem generalized. Also, he would prefer that the proposed scheme should operate in the context of a Fund-supported program. He therefore hoped that agreement could be reached on a new Fund-supported program before the proposed arrangements between Bolivia and its creditor banks were brought into effect.

Ms. Bush remarked that her authorities could support Bolivia's request, which they viewed as unique. The role proposed for the Fund would facilitate Bolivia's attempt to regularize its financial relations with its creditors.

The arrangement Bolivia had negotiated with its creditors had some important characteristics, Ms. Bush observed. It was entirely voluntary; it had the unanimous support of Bolivia's creditors; and the Fund would play a neutral role with respect to the arrangement.

The Fund's role was narrow, prescribed, and administrative, Ms. Bush continued. That the substance of the arrangement was agreed prior to requesting the Fund to play a role was reassuring evidence that that role would truly be an administrative one. It was also important that the Fund would incur no liabilities and that the Instrument should be written tightly. In that regard, she understood that Section 6(c) of the Instrument, which stated that the property and assets in other Fund accounts

should not be used to reimburse the Voluntary Contribution Account, entirely protected the Fund from any liability. She also expected that the arrangement would not be generalized. Finally, it was important that Bolivia was implementing an adjustment program supported by the Fund while trying to regularize its relationship with the country's creditors.

Mr. Posthumus remarked that the Board should not comment on the nature of the buy-back arrangement, which was the responsibility of Bolivia and its creditors. Moreover, it should not discuss the implications of the arrangement for the debt strategy, as proposed by Mr. Prader, unless Directors agreed that the arrangement fitted into the case-by-case approach of the debt strategy.

In general, he agreed with the comments by Ms. Bush and Mr. Foot, Mr. Posthumus continued. He accepted the proposed role of the Fund, which was an administrative one, in Bolivia's case. More specifically, the staff paper indicated that management supported the role for the Fund, provided that the Fund was satisfied, among other things, that the financing and modalities of the buy-back were consistent with Bolivia's economic and financial program. That proviso had not been reiterated in the letter from the Minister of Finance for Bolivia or in the Acting Chairman's opening statement. He therefore wished to verify that understanding with respect to the Fund's role.

Mr. Goos said that he could support the proposed decision. His authorities wished to stress a few points in that regard. First, they felt that the establishment of the Account constituted a purely technical service provided by the Fund to Bolivia and that the Fund's consent to the establishment of the Account was without prejudice to possible contributions. Moreover, in dealing with the parties involved in the buy-back, and also in presenting the scheme to the public, the Fund should indicate that its role was one of neutral assistance.

His authorities attached particular importance to the statement in the staff paper that the Fund would not incur any obligation or liability by reason of the establishment, administration, or termination of the Account, Mr. Goos continued. In any case, the Fund's obligations and liabilities should not go beyond those ordinarily associated with the administration of resources. Given the importance of that matter, his authorities would have preferred to see in the draft Instrument an explicit reference to such limitation of the Fund's liability. However, he had been reassured in that regard by the staff's responses to Directors' queries.

Mr. Zecchini made the following statement:

> The proposal for a Voluntary Contribution Account for Bolivia is innovative in many respects, yet does not seem to contradict the general approach to the debt problem that the Fund has been following in the last few years. The proposed

innovations aim at adapting the financial support of the international community to the excessive level of Bolivia's external indebtedness, to the difficult economic conditions of the country, and to its very limited ability to service its foreign debt. In this respect, it is evident that Bolivia's compliance with its present comprehensive adjustment program is not sufficient to allow for the restoration of normal relations with its creditors. Only in light of these considerations can we agree with the proposal to establish an Account to facilitate the buy-back of bank debt by Bolivia. More generally, however, we share some of the reservations expressed by Mr. Marcel on the advisability of this approach, unless it is framed and regulated in the context of a more systemic approach to the debt problem, which would involve rights and obligations of all the parties involved, namely, official and private creditors, debtors, and international institutions.

The degree of success of this initiative is uncertain, as it depends on many factors, including, most importantly, the size of the contributions and the degree of unconditionality related to them; the price offered by the Bolivian authorities for the buy-back; and the amounts of assets vis-à-vis Bolivia that the commercial banks are willing to sell. Under the best conditions, if all commercial debt is bought back, Bolivia's external public debt would still be about equal to its annual GDP.

This leads me to a consideration about the usefulness of the buy-back approach. It has been said that this initiative will contribute to a restoration of Bolivia's relations with its creditors. But which creditors are most affected by this scheme? On the one hand, Bolivia has not received any new commercial bank loan in the 1980s, and it is unlikely that it will receive any substantial loan from commercial banks in the near future even if the buy-back scheme were to succeed. After all, following the buy-back, banks will record significant losses on their loans to Bolivia. Moreover, the country's ability to borrow on commercial terms does not appear to be significantly enhanced even after the successful completion of the buy-back as well as of the adjustment program accompanying the buy-back. On the other hand, official creditors do not benefit directly from this scheme.

Therefore, what is the ultimate objective being pursued through this initiative? A clarification on this point would be of great interest to the Board. Moreover, it will be useful and appropriate for the Board to reconsider the effectiveness of this approach once the scheme has been fully implemented and the staff has provided all relevant information.

Mr. Fogelholm said that his chair could support the proposed decision. His authorities did not think that the Fund should stand in the way of a voluntary buy-back arrangement of the kind proposed for Bolivia. On the contrary, it was in the interest of the Fund to participate in realistic, novel solutions to the debt problem and to assist member countries in that respect. As Mr. Posthumus had often stressed, there were many approaches to the debt strategy. He subscribed to that notion. The proposed arrangement for Bolivia was one such approach.

Mr. Sugita remarked that his authorities would not object to the proposal that the Fund establish a Voluntary Contribution Account and play an administrative role with respect to the debt buy-back scheme for Bolivia, while not committing themselves to the scheme itself. However, their passive support applied only to the particular case of Bolivia. There were reasons for the Fund to be cautious about the degree of its involvement in administering accounts for various financial transactions, given its resource constraints.

Under the "menu approach" to the debt strategy, it was likely that requests for the Fund to take an administrative role in accommodating transactions between debtor countries and their creditors would increase, Mr. Sugita considered. But if the administrative work could be dealt with by commercial institutions or official institutions other than the Fund, then the Fund generally should refrain to the extent possible from taking on such a role. For Bolivia, the buy-back scheme was structured in such a way that Fund involvement might be necessary.

Mr. Hassan said that the Bolivian authorities had been implementing a comprehensive adjustment program with the support of the Fund to address the difficult problems facing their economy and to cope with its heavy debt-servicing burden. His chair had continuously maintained that the exceptionally difficult debt problem of low-income countries such as Bolivia would require special treatment and innovative approaches. The buy-back arrangement was one possible approach; it should be given a chance to work in order to see how it contributed to the resolution of the debt problem of low-income countries.

One concern was the possibility that aid flows, which would have been available to support Bolivia's adjustment efforts in the absence of the buy-back arrangement, would be redirected to finance the buy-back, thereby reducing the external finances available to Bolivia, Mr. Hassan added.

A number of Directors had stressed that Bolivia's request should be treated as a special case and should not be taken as a precedent, Mr. Hassan noted. However, a number of low-income countries, particularly in Africa, were facing circumstances similar to Bolivia's and requests for similar facilitating arrangements should be considered. Such requests should be considered on a case-by-case basis, and the possibility of assisting other low-income countries, if circumstances warranted, should not be ruled out.

He wondered whether the buy-back arrangement had any formal connection with Bolivia's program in support of its structural adjustment arrangement with the Fund; and if so, what was its nature, Mr. Hassan said. Finally, he supported the proposed decision.

Mr. Vasudevan remarked that the issue before the Board was an administrative one. Moreover, the role proposed for the Fund was a passive, but helpful one, particularly in view of Bolivia's ongoing efforts to bring about structural adjustment under a structural adjustment arrangement from the Fund. He therefore could support the proposed decision.

Mr. Toé remarked that he supported the proposed decision and wished to associate himself with the comments made by Mr. Hassan.

Mr. Ismael said that his chair could support the proposed decision on the understanding that, with respect to the buy-back scheme, the Fund's role was limited to that of a neutral administrator, and that administration of the Account would not involve the use of Fund resources.

Mr. Chatah remarked that he shared Mr. Ismael's view and that he supported the proposed decision. He also appreciated Mr. Hassan's comments on the debt strategy and low-income countries. He would appreciate the staff's comments on the unique nature of Bolivia's request; was more involved than the special economic and financial circumstances of Bolivia?

Mr. Salehkhou, Mr. Hospedales, Mr. Jiang, and Mr. Lim said that they supported the proposed decision.

The staff representative from the Western Hemisphere Department, commenting on the contribution of the buy-back to the normalization of relations between Bolivia and the commercial banks, observed that the Bolivian case was, indeed, special insofar as Bolivia, which had not borrowed from commercial banks during the 1980s, had initiated a stabilization program in 1985 that eschewed such borrowing in the future. Nonetheless, Bolivia's relations with the commercial banks had remained highly irregular. Only partial payments had been made to banks since September 1982, and none had been made after March 1984. Therefore, Bolivia needed to regularize relations with commercial bank creditors, even though no new recourse to borrowing--other than possibly short-term trade financing--was being sought. Moreover, the staff's medium-term scenario indicated that the country could not service its debt under present repayment terms. For that reason, a special plan had been worked out with commercial bank creditors.

The buy-back was but one feature of the effort to normalize relations, the staff representative continued. It was to be accompanied by a debt-equity swap followed by a renegotiation of the unredeemed amount of principal. However, it was understood that the buy-back results would affect Bolivia's ability to service its remaining debt. Under the Government's liberal economic policy, individual enterprises in the private sector

were, of course, free to seek bank financing, but the public sector would not borrow. Indeed, banking regulations in some countries would probably require an immediate write-down of new sovereign lending to Bolivia, so that fresh loans to the public sector would not be available at the present stage.

Whether the buy-back would weaken the authorities' adjustment effort was not an issue with respect to Bolivia, the staff representative observed. From the beginning, discussions between the authorities and the staff envisaged some innovative solution to Bolivia's commercial bank debt problem as long as such innovations did not weaken the adjustment effort. Moreover, contributions to the buy-back were not expected to reduce aid commitments from individual bilateral creditors. Thus, the program had taken into consideration the likely financing flows, and the staff would be monitoring developments in that area.

A few speakers had urged a rapid disclosure of the amounts committed or paid into the Account, the staff representative noted. According to the draft Instrument, the Fund would not be free to disclose such information until the buy-back had been concluded.

The buy-back arrangement was consistent with Bolivia's program, the staff representative from the Western Hemisphere Department remarked. There was a formal linkage between the two insofar as any prefinancing by Bolivia of contributions with its own resources would lead to an adjustment in the ceilings for net international reserves and net domestic assets.

The staff representative from the Legal Department noted that there was no formal linkage between the proposed Account and any arrangement for Bolivia from the General Resources Account. The Instrument itself did not make any provision for the termination of service, say, for Bolivia's failure to implement its economic and financial program. It was management's present finding that the Fund was satisfied that the financing and modalities of the buy-back were consistent with Bolivia's economic and financial program, which had provided the basis for bringing the proposal to the Board for consideration.

On the question of liability, he wished to add that the Fund's use of reasonable care and skill and the avoidance of unreasonable risk would be sufficient to avoid any legal liability, the staff representative remarked. Moreover, the use of a disclaimer to insulate the Fund from any liability for malpractice had not been the practice of the institution.

Banks' participation in the scheme was entirely voluntary, and it was important that the Fund was not acting at the request of the banks, but at the request of Bolivia, the staff representative continued. As for the relationship between the Fund and Bolivia, the Instrument clearly stated that the assets, property, income, and liabilities of the Voluntary Contribution Account were separate from those of all other Fund accounts.

The decision would not establish a precedent because no entitlement was involved, the staff representative from the Legal Department commented. Thus, future requests of a similar nature would have to be evaluated on the basis of the economic and financial circumstances of the member.

The Deputy Treasurer remarked that the draft Instrument, particularly paragraphs 3(j) and (k), precluded the staff from disclosing information regarding the Account, except under the particular circumstances provided for in the draft Instrument. Therefore the staff would not, in principle, be able to meet Mr. Marcel's request.

With regard to administrative costs, the Fund would not charge Bolivia for the services provided, the Deputy Treasurer continued. The implementation and administration of the Account would not be unduly burdensome, but in view of the Fund's tight budgetary resources, a detailed accounting of costs would be kept, and if costs proved to be excessive, the matter would be brought to the Board's attention.

The staff representative from the Exchange and Trade Relations Department, commenting on the buy-back and the need for Bolivia to normalize relations with creditor banks, observed that the market value of Bolivia's debt had risen from about $0.07 per dollar to $0.09 to $0.11 since the buy-back announcement. But the discount remained sufficiently deep to make a buy-back operation a reasonable avenue for reducing the country's contractual debt burden. "Normalization," in a broader sense, meant regularization of the relationship between creditor and debtor. Since there had been no servicing of Bolivia's debt for some time, the resumption of contractual obligations and agreement with creditors on what those obligations constituted was a significant step which, however, depended on reducing the stock of outstanding debt. Overall, the Bolivian case was unique. In that light, and in view of the rise in the secondary market price of Bolivian debt, the question of moral hazard was irrelevant: the Bolivian Government already had shown its commitment to the adjustment path agreed with the Fund and to regularizing its contractual obligations; in the circumstances, it would be difficult for the authorities to drive down the market price of Bolivia's debt.

Mr. Donoso remarked that the normalization of relations with creditors was central to Bolivia's request. A question had been raised whether, in light of Mr. Dooley's analysis of buy-backs, such an operation would benefit Bolivia. While Mr. Dooley had provided a valuable framework for analyzing buy-back operations, it assumed that the total resource transfer would be constant. That framework was not entirely realistic because it did not include factors such as the effect of normalization on investment and on the generation of income within the country. Particularly with respect to Bolivia, the additional benefit derived from the normalization of relations was significant.

It was also important that the buy-back was only one element of Bolivia's debt strategy, which also comprised debt-equity swaps and the rescheduling of remaining debt with commercial banks, Mr. Donoso continued.

That strategy was expected to result in the complete normalization of relations with creditors. Thus, there was a possibility that Bolivia might resume borrowing in the near term; for example, it might regain access to short-term financing for trade, which was important and necessary for Bolivia. The successful completion of the operation was potentially a positive, important factor for improving Bolivia's economic situation, particularly its external situation.

It was also important that the Fund would provide its technical services, while leaving the details of the arrangement to creditors and the country, Mr. Donoso considered. That approach was consistent with the case-by-case approach of the debt strategy. He was therefore somewhat surprised and dismayed by the importance some Directors attached to the exact content of the arrangement and to the neutrality of the Fund with respect to it.

The Acting Chairman remarked that it had taken some time to bring Bolivia's request to the Executive Board for consideration owing to lengthy discussions between the staff, management, and the authorities on many of the questions that had been raised by Directors. The Fund's role was a passive one--as many Directors had emphasized--in the sense that the buy-back arrangement had been voluntarily agreed between Bolivia and its creditors. The Fund's involvement, however, lent some credibility to the buy-back exercise. In that respect, it was notable that the arrangement was consistent with Bolivia's economic program, was not contrary to the general debt strategy, and did not raise serious concern with respect to moral hazard.

The Fund was not assuming any financial liability in granting Bolivia's request, the Acting Chairman continued. As for whether the scheme would work, he agreed with Mr. Hassan that it should be given a chance; the Board could review its operation at a later stage, after the buy-back had taken place.

The unease expressed by some speakers with respect to countries' debt trading at a discount in secondary markets was certainly understandable, the Acting Chairman observed. Nevertheless, discounted debt buy-backs--both direct and indirect--were taking place in secondary markets. The question remained whether there should be guidelines or criteria governing those transactions. By contrast, Bolivia was conducting its debt buy-back in an open, transparent manner. All parties, including the Fund, were aware of the terms and conditions. Indeed, some criteria that Directors thought should be met to justify the Fund's involvement, should also apply in those instances where transactions were less transparent. The Board might wish to return to that issue during its discussion on the debt strategy.

The Executive Board then took the following decision:

1. Pursuant to Article V, Section 2(b), the Fund adopts the provisions of the Instrument set forth in the Annex to EBD/87/251

(10/5/87) that establish an Account for the administration by the Fund of resources to be contributed for the benefit of Bolivia.

2. The provisions of the Instrument set forth in the Annex may be amended only by a decision of the Fund and with the concurrence of Bolivia.

Decision No. 8713-(87/147), adopted
October 21, 1987

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/87/146 (10/16/87) and EBM/87/147 (10/21/87).

2. PEOPLE'S REPUBLIC OF MOZAMBIQUE - TECHNICAL ASSISTANCE

In connection with the technical assistance mission to the People's Republic of Mozambique in the tax area approved by the Executive Board on October 14, 1987 (EBD/87/257, 10/9/87), the Executive Board approves the proposal set forth in EBD/87/257, Supplement 1 (10/16/87).

Adopted October 20, 1987

3. UGANDA - TECHNICAL ASSISTANCE

In response to a request from the Ugandan authorities for technical assistance relating to the banking system and financial policy, the Executive Board approves the proposal set forth in EBD/87/261 (10/14/87) and Supplement 1 (10/15/87).

Adopted October 16, 1987

4. APPROVAL OF MINUTES

a. The minutes of Executive Board Meetings 87/44 through 87/48 are approved. (EBD/87/256, 10/9/87)

Adopted October 16, 1987

b. The minutes of Executive Board Meetings 87/49 through 87/52 are approved. (EBD/87/260, 10/14/87)

Adopted October 20, 1987

5. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/87/221 (10/15/87) and EBAP/87/222 (10/16/87), by an Advisor to Executive Director as set forth in EBAP/87/221 (10/15/87), and by an Assistant to Executive Director as set forth in EBAP/87/220 (10/14/87) is approved.

6. TRAVEL BY MANAGING DIRECTOR

Travel by the Managing Director as set forth in EBAP/87/225 (10/20/87) is approved.

APPROVED: May 17, 1988

LEO VAN HOUTVEN
Secretary