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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 86/143

10:00 a.m., September 3, 1986

J. de Larosière, Chairman
R. D. Erb, Deputy Managing Director

Executive Directors	Alternate Executive Directors
	J. K. Orleans-Lindsay, Temporary
C. H. Dallara	
	H. G. Schneider
	M. Z. M. Qureshi, Temporary
H. Fujino	M. Sugita
	B. Goos
	Yang W., Temporary
J. E. Ismael	
	J. Hospedales, Temporary
	M. Foot
	S. Simonsen, Temporary
M. Massé	L. Leonard
	A. Abdallah
	M. A. Weitz, Temporary
Y. A. Nimatallah	J. E. Suraisry
	G. Ortiz
H. Ploix	S. de Forges
	J. de Beaufort Wijnholds
C. R. Rye	A. V. Romuáldez
G. Salehkhou	O. Kabbaj
A. K. Sengupta	
S. Zecchini	

J. W. Lang, Jr., Acting Secretary
K. S. Friedman, Assistant

Also Present

IBRD: G. Tidrick, Operations Policy Staff. European Department: P. B. de Fontenay, Director; S. Mitra, P. M. Nagy. Exchange and Trade Relations Department: C. D. Finch, Counsellor and Director; W. A. Beveridge, Deputy Director; G. Bélanger, C. Brachet, E. H. Brau, B. de Schaetzen, K. B. Dillon, L. Hansen, H. Hino, R. B. Johnston, E. R. J. Kalter, G. R. Kincaid, C. M. Watson. External Relations Department: D. D. Driscoll, H. P. Puentes. Fiscal Affairs Department: E. Namor. IMF Institute: O. B. Makalou. Legal Department: W. E. Holder, A. O. Liuksila, R. H. Munzberg. Middle Eastern Department: E. B. Maciejewski. Research Department: W. C. Hood, Economic Counsellor and Director; R. R. Rhomberg, Deputy Director; M. C. Deppler, D. Folkerts-Landau, M. D. Knight, F. Larsen, D. J. Mathieson. Treasurer's Department: W. L. Coats, S. Nocera. Bureau of Statistics: J. B. McLenaghan, Deputy Director; C. Briançon, K. W. O'Connor. Personal Assistant to the Managing Director: R. M. G. Brown. Advisors to Executive Directors: P. E. Archibong, W.-R. Bengs, M. B. Chatah, L. P. Ebrill, S. Ganjarerndee, A. Ouanes, R. Valladares, A. Vasudevan. Assistants to Executive Directors: O. S.-M. Bethel, J. de la Herrân, W. N. Engert, R. Fox, V. Govindarajan, M. Lundsager, T. Morita, J. Reddy, J. E. Rodríguez, G. Seyler, B. Tamami, L. Tornetta, H. van der Burg, B. D. White.

1. INTERNATIONAL CAPITAL MARKETS - DEVELOPMENTS AND PROSPECTS, 1986

The Executive Directors considered a staff paper on Recent Economic Developments in and Prospects for International Capital Markets (SM/86/193, 8/5/86; and Cor. 1, 8/28/86). They also had before them staff papers entitled International Banking Activity in the First Quarter of 1986 (SM/86/218, 8/26/86), International Capital Markets - Recent Developments, 1986 (SM/86/201, 8/14/86; Cor. 1, 8/28/86; and Sup. 1, 8/14/86), Multilateral Development Banks - Recent Activities (SM/86/208, 8/20/86), Recent Experience with Multilateral Debt Restructuring (SM/86/84, 8/7/86), and Export Credit Developments, 1984-85 (SM/86/223, 8/26/86).

Mr. Ortiz made the following statement:

While the comprehensive and informative staff papers prepared for this discussion report on a number of important developments in the international capital markets that merit detailed discussion, I will focus my reports mainly on debt-related issues. The papers that we are considering today seem to be particularly useful in the light of our previous discussion on the debt situation, in March 1986. The staff papers that were considered on that occasion provided a good analytical background on the origins of the debt problem and on the strategy followed thus far. These papers on capital markets are in a sense complementary, as they provide a view from the credit supply perspective and contain a number of illuminating insights provided by the creditors themselves, which allow us to draw a better overall picture.

As a starting point for this discussion on debt situation and the debt strategy, it is useful to summarize the conclusions that were reached by this chair during the March 1986 discussion. First, debtor countries have made strenuous adjustment efforts, reflected in the improvement in their current account position. This improvement has been of a magnitude that "few could have imagined," as the Managing Director said in a recent speech. The counterpart has been a dramatic compression of per capita income, consumption, and living standards--I need not cite again the well-known figures. In addition, both banks and official creditors have largely collected interest on their credits in a normal fashion.

Second, despite these efforts and the enormous costs involved, the capacity to pay of debtor countries--as measured by standard indicators such as the debt/export ratio or the debt/GDP ratio--has deteriorated over the previous four years. Economic growth has not resumed--with perhaps the exception of Brazil--and growth prospects remain as bleak as ever for investment, particularly in Latin America, where investment has taken such a steep downturn that growth possibilities might have already been impaired in a number of cases.

A striking feature of the adjustment process of debtor countries over the previous four years is their extreme vulnerability to external shocks. An important development in the debt situation that was widely cited in 1984 and early 1985 was the fact that debtor countries appeared to have overcome the stage of import compression, and that a new phase on the export-led road to creditworthiness was in sight. It took only one year of sluggish economic activity in industrial countries to drastically modify this view. Recent developments--as described in the current world economic outlook report--have reinforced this pessimistic trend.

Fourth, the implementation of "orthodox" schemes in the presence of high indebtedness and a high rate of inflation entails a number of difficulties. In particular, high inflation often results from the redistributive effects that are implied by the real resource transfer effected abroad. Efforts to reduce inflation through traditional policies result in a much greater reduction in output than in cases in which debt is not a serious problem. In this sense, Fund-supported programs have had a markedly contractionary bias. At the same time, supply-side structural policies, while certainly necessary in many cases, take a much longer time than demand-oriented measures to make their effects felt in the economy. All this implies that much more flexibility in the design of Fund programs is called for.

Fifth, accordingly, it was the view of my authorities that the debt strategy was no longer working. The Baker initiative was a welcome development, as it recognized that countries must grow out of their debt problems. However, its building blocks were insufficient to solve the problems. My authorities considered then that the debt strategy must be revamped within a framework of coresponsibility and burden sharing. Debtor countries should maintain their adjustment efforts in a growth environment, with particular emphasis on structural policies; industrial countries must take renewed actions to provide a better environment through policy coordination; and creditors should undertake an increased share of the debt burden. My *authorities were implying that the real resource transfer abroad* by debtor countries must be drastically reduced. In turn, this essentially entails a reduction in interest payments, since the principal of the debt has practically been restructured. This could be accomplished in several ways, including a concerted effort to reduce interest rates; a reduction of spreads as well as the capitalization of interest payments, possibly at below-market rates; equity swaps and on-lending operations; and selected debt cancellation, conditioned perhaps on the maintenance of adjustment efforts.

In commenting on recent developments on the debt front, I wish to refer first to the information provided by the updated world economic outlook paper that will be considered by the Executive Board in detail next week. The main findings that are of particular interest for this discussion, since they refer to financing issues, are accurately captured in the final paragraph of page 11 and the first paragraph of page 12 of the world economic outlook paper. The staff now foresees a much tighter situation than six months ago. The main elements of the final picture are a virtual cessation of reserve accumulation, with larger reserve losses among fuel exporting countries being combined with lower reserve gains among fewer importers; a renewed buildup of arrears; a steep rise in the amount of debt rescheduled; a subdued pace of official lending (which at about $20 billion per annum in 1985-87 is running at only about two thirds the rate of 1981-84); and continuing weakness in private lending, which is expected to average only about $10 billion a year. Despite these extremely low levels of borrowing, debt outstanding and debt ratios are expected to rise in 1986...."

The world economic outlook paper prepared for April 1985 predicted debt/export ratios of 246 percent, and 186 percent, respectively, for 1986 and 1988 in the case of debt problem countries. Last April's exercise had revised these figures to 275 percent for 1986 and to 261 percent for 1987. Under the current exercise, the corresponding figures for 1986 and 1987 are 292 percent and 285 percent, respectively. Thus, in 18 months the debt/export ratios for 1986--to take a single year--for this group of countries has been raised by 46 percentage points.

The staff has consistently overestimated the improvement in the debt situation and underestimated the worsening of the debt coefficients. The costs of the adjustments in terms of economic growth of debtor countries have also been consistently underestimated. It appears that each revision lowers the previous growth forecast and revises downward the expected evolution of these countries' terms of trade. Non-oil commodity prices are now expected to fall a staggering 18 1/2 percent in real terms in 1986 compared with a decline of only 2 percent that was foreseen in the April version of the world economic outlook paper, yet these appear to be the most widely utilized projections for gauging progress on the debt front. Given the consistently overly optimistic--but unfortunately wrong--projections, it is perhaps not suprising that the Fund has endorsed the current debt strategy for so long.

Being perhaps aware of the deteriorating situation of developing countries, the authors of the latest world economic outlook paper add on page 24 that "it would not be an exaggeration to say that promoting sustainable growth in developing countries is the single most important objective of international economic management." This is a nice thought, although one should not take too much comfort from it, as it comes from an area of the Fund that refuses to even acknowledge the concept of resource transfer from debtor countries. The Fund must be by now the only institution in the world in which economic analysis of the debt situation does not explicitly incorporate this concept.

In commenting in more detail on recent financial trends it might be useful to begin by summarizing a few relevant developments that are described in SM/86/193. The bond market, which has become the most rapidly growing segment of the capital markets, is open to only a handful of developing countries, mostly countries in Asia. The hope of tapping this market for the great majority of developing countries remains dim--especially for countries experiencing debt difficulties.

Total bank lending to developing countries has dropped from \$82 billion in 1981 to \$34.7 billion in 1983, \$16 billion in 1984, and \$9 billion in 1985. The increase in exposure in 1985 was of the order of 1.6 percent. The regional breakdown shown in Table 3 is striking: while Asian countries received about 25 percent of bank credits in 1983, the proportion was 56 percent in 1986. This implies that the increase in commercial bank exposure in Latin America was of the order of 0.7 percent. Viewed from another perspective, new bank lending to Latin America probably amounted to less than 10 percent of the interest collected from the region.

Spontaneous lending has come to a halt not only for the group of problem debtor countries, but also for many others. The contagion problem seems to be acute, especially in Latin America. Concerted lending packages are becoming increasingly difficult to arrange. Disbursements under those packages were halved from the 1984 level to about \$5 billion. New commitments for 1985 and the first six months of 1986 amounted to \$2.5 billion compared with \$16.5 billion in 1984.

When questioned by the staff about factors that would influence their willingness to lend to developing countries, banks indicated that the main factors were developing countries' economic policies and prospects and a healthy and growing world economy. They also indicated that efforts to repatriate flight capital would have a major influence on their lending decisions. These considerations would almost seem humorous if the situation were not so dramatic. Since lending decisions depend upon developing countries' prospects, perhaps we should seek to prevent bankers from obtaining a copy of the latest world economic outlook revisions. With respect to capital flight, it is difficult not to see some irony in the banks' concerns; commercial banks themselves have been extremely active in the promotion of capital flight from developing countries through their representative offices and deposit-taking departments. Perhaps the banks should make a distinction among themselves as to which group wishes to see more capital flight and which does not.

It is a fact that banks today are a much less cohesive group than they were at the time of the eruption of the debt crisis in 1982. Since banks have different regional interests and have followed diverse procedures to increase their capital asset ratios, reduce absolute or relative exposure to developing countries, and make provisions against some of these loans, it is clear that the consolidation of concerted lending packages is currently a much more difficult process--and it was never an easy process. In a sense, the role of the advisory committees is now less effective, since apart from the different views of member banks, they face a much more heterogeneous constituency. One way of getting around these difficulties is to consider a "menu" of options for banks that would include different financing modalities depending on the interest of banks in participating in packages and their willingness to do so. The problem with this sort of arrangement is that it would probably take a long time to negotiate, and, of course, time is not an abundant commodity for countries that are hard pressed to obtain additional financial resources.

I was interested in the remark made by advisory committee banks that "economic subcommittees could play an even greater role in preparing assessments of policies and prospects in developing countries." Since bank lending to debt problem countries takes place routinely in the context of Fund-supported programs, economic subcommittees are actually confined to reviewing the work done by the staff, since the banks' economists certainly do not have the means with which to duplicate the Fund staff's appraisal of the quality of appraisals for countries' prospects. It would appear that their main job is to probe into the balance of figures and to find ways in which banks can reduce their participation in meeting the overall financing needs.

Burden sharing among banks is a difficult issue. The reduced degree of cohesion among banks that poses so many problems for the formulation of concerted lending packages should also have a positive effect, as it should, at least in theory, permit a more differentiated approach to financing. The difficulty is that individual banks would have to agree on the terms and conditions of the arrangements not only with their own clients, but also with other banks. These problems, which are typical of cartel-type organizations, have in a sense been fostered by the way in which both creditor governments and multilateral organizations have approached the whole debt situation. In the name of "preserving" the stability of the international financial system and of avoiding a "systemic reaction," creditor governments and the Fund instituted a system of "punishment" and "rewards" in which countries were to deal individually with groups of creditors, thereby institutionalizing the banks' cartel.

However, this punishment/reward system is becoming increasingly unbalanced. The rewards for debtor countries were to be, of course, the possibility of re-establishing adequate growth rates and the return to normal relations with their creditors. The growth prospects have not materialized, and the possibility of re-establishing normal relations with creditors--meaning a return of spontaneous financing--remains an illusive goal, as banks themselves recognize. As a result, the contradictions that are inherent in the current strategy have become more evident. On the one hand, banks are increasingly reluctant to participate in concerted lending schemes but warn against countries' requesting interest reschedulings on the ground that this implies a departure from market-oriented financing. On the other hand, banks are also reluctant to consider schemes of genuine debt relief, including forgiveness of debt and below-market interest rates. They consider that these proposals are premature and they argue that a number of very different issues arise in the selection of appropriate criteria to determine eligibility and the scale of relief and that there is a potential problem of contagion. The fear of setting "precedents" in debt renegotiations is of overriding importance. However, banks' creditors and international organizations claim to be following a case-by-case approach. Does this mean that the magnitude of the spreads or the cutoff rate in Paris Club arrangements should be tailored to individual situations? If this is the correct interpretation, then the scope of this approach is very limited.

Much more flexibility needs to be introduced in dealing with the debt situation on the part of creditor banks, governments, regulators, and international organizations. Financing by multilateral official creditors should be decoupled from bank financing. During the 1930s, all Latin American debtors except Argentina defaulted unilaterally on their external obligations. Latin American countries were later able to normalize their relations with creditors because of the availability of market mechanisms for buying back debt at a discount. In a sense, swap and on-lending operations are parallel to those operations. But the key to the recuperation of these economies and to the ultimate payment of part of the debt was that the countries obtained substantial debt relief that allowed them to attain significant investment levels and satisfactory rates of economic growth. It seems that now, as in those years, these will have to be important ingredients in a solution to current problems.

Mrs. Ploix made the following statement:

This impressive volume of information encompasses a wide variety of issues. It will be helpful to all potential readers to have it regrouped and published as an Occasional Paper.

The issue of international capital markets is a large one, and as Secretary Baker said at the 1986 Annual Meetings, the examination of the situation and the search for solutions to the problems facing the whole financial community require a thorough analysis of the behavior of all the parties concerned. That is why the Executive Board examines staff reports on countries undertaking adjustment programs and appraises the help that the international community is able to give them. My authorities continue to believe that this case-by-case approach is the only conceivable one.

Today's discussion is a relatively general one. It is not feasible to review all aspects of the various issues at hand, and since I broadly agree with the thrust of the staff's comments on most points, I will concentrate on the recent attitude of commercial banks toward developing countries and on the need for coordination that is called for by recent developments in capital markets. The paper on the Paris Club is interesting but also is so thorough that I need not comment on it.

The attitude of commercial banks toward developing countries remains a cause for great concern to my authorities, who hope to have an opportunity to discuss it during the next ministerial meetings. The figures on the most recent developments are not yet available, and it is therefore somewhat difficult to have a clear picture of the impact of the new momentum that was started at the 1986 Annual Meetings. Nevertheless, I do not expect such developments to reverse the medium-term trends substantially, and this is confirmed in the latest world economic outlook paper. The net increase in bank claims on developing countries in 1985 slowed to $9 billion, from $6 billion in 1984. Moreover, as the staff stressed in its paper on export credits, a significant part of this increase was due to new official export credit guarantees. This modest increase was largely concentrated on Asian and European countries; the corresponding figure for the countries on the Baker list is zero for 1985, compared with $5 billion in 1984. Commitments under concerted packages diminished from $16.5 billion in 1984 to $2.5 billion in the period January 1985-July 1986. These figures are all the more disquieting because the financial needs of developing countries did not decrease last year and are likely to increase in 1986 and 1987 given the trend in the terms of trade of those countries.

My authorities consider that this dangerous behavior by the commercial banks is unwarranted for at least four reasons. In most cases, the banks' partners have implemented policies that have had the effect of providing comfort to the banks that are concerned about their financial situation.

First, developing countries are implementing strong and comprehensive adjustment policies, often under Fund-supported adjustment programs. Second, the multilateral development banks are increasing their financing and are reforming their procedures in order to permit more rapid disbursements and to facilitate closer collaboration with other institutions, including commercial banks. Third, the governments of the major industrial countries are increasing their cooperation in formulating policies with a view to improving and stabilizing the international economic environment. It is unnecessary to describe now the details of the decisions that have been taken over the previous 12 months that were aimed at lowering interest rates, adjusting exchange rates, resisting protectionism, and reaffirming that recession is not needed to correct imbalances.

I understand the concerns that have been expressed by the Bank's representatives, which are described in the main staff paper. A number of areas of distress admittedly remain, especially the issue of capital flight. At the same time, financing needs other than those of developing countries have to be met, although this could be done without such significant crowding out as has appeared. Adjustment is an ongoing process that unfortunately can involve relapses. Nevertheless, the intervention of the commercial banks remains absolutely essential, and I believe that the recent improvement in their financial situation, particularly through the increase in provisioning, gives them a generally greater latitude in which to intervene. The French banks have increased their exposure to developing countries by at least 2 percent a year in real terms since 1982. I am therefore deeply concerned about the reticence of some banks to play their role in the movement that was launched last year; leading banks have reduced their total lending to developing countries.

In the area of the need for coordination stemming from recent developments in capital markets, my authorities continue to favor the general movement toward liberalization and innovation that characterizes the international financial markets. My authorities have recently implemented a variety of important measures of liberalization, including the relaxation of exchange controls and the reopening of the Eurofranc bond market, and they are committed to further increasing the flexibility and integration of the various markets.

Therefore, the recent trends in these areas are not a cause for concern, although adequate attention must be paid to them. There should be increased cooperation among national supervisory authorities in order to better define the rules of the game, especially as an increasing number of currencies is involved. The staff illustrates the need for this coordination on page 28, where it refers to the "regulatory arbitrage" that might result from differences in national practices. More generally, it is clear that the creation of international liquidity is multicenter and multicurrency in nature. It remains to be proven that at all times global liquidity is at the optimum level and that its stability is assured. On the contrary, there are reasons to fear that the tendency in the market to overreaction could endanger the necessary minimal stability. The development of information given to largely integrated markets increases their ability to react on a large scale to small changes in conditions. In sum, national policies have an increased influence on external developments. Without impeding each government's freedom to act, the analysis of interactions must be a major component of the decision-making process, especially in the monetary field. In the eyes of my authorities these considerations are an essential part of the general debate on the functioning of the international monetary system. My authorities will therefore be very interested in hearing the comments of other members of the Interim Committee on this topic at the next meeting of that Committee.

Mr. Ismael made the following statement:

The staff papers are essential reading for anyone with an interest in the subject and should be published in the Occasional Paper series. Secretary Baker's so-called debt initiative received considerable attention and wide support when it was revealed for the first time at the 1985 Annual Meetings. It also became the focus of our discussion at the 1985 review of the international capital markets. Several positive elements of that initiative can now be seen both in the Fund's and the World Bank's policies for tackling the debt problem--particularly the growth-oriented strategy of adjustment and the increased role for the Fund in providing policy advice and balance of payments financing support. The supply-side focus of that effort has been warmly received by many members. Furthermore, the enhanced collaboration between the World Bank and the Fund has now become the standard operating procedure of these institutions.

The most important, perhaps vital, component of the Baker initiative is obtaining an increase in commercial bank participation, especially for the highly indebted countries. Unfortunately, this aspect of the initiative is not apparent today despite the pledges by commercial banks that were made in support of the initiative, which was to include $20 billion in new bank lending, an amount that was considered by many to be only the minimum required. It was also said that an increase in the banks' exposure of less than 3 percent in 1984 was judged as being only moderate. Therefore, I am surprised to see that no mention of that initiative is made in the current review papers. At the least, there should be a small assessment of what has become of that initiative, particularly the progress to date. I have made references to the Baker initiative because there seems to be a disturbingly slow increase in bank claims, which totaled only $9 billion in 1985, representing an increase of only 2 percentage points in the growth rate over 1984.

A positive aspect of the capital markets over the last year, however, was the dramatic increase in the international bond issues, which, I believe, was not related to the Baker initiative. This development is of course relevant in terms of the actual resource flows to the developing countries, but its use, as expected, has been limited to only a few countries that already have good market access. Therefore, it does not offset the fact that many of the other highly indebted countries have not had the benefit of increased bank exposure to assist their adjustment effort.

An interesting aspect of the market that is becoming increasingly important is the readiness shown by some banks to consider new modalities of financing. For example, some bank loans have been transformed into longer-term investments through arrangements to convert debt into equity. Although the amount involved thus far has been small, I am optimistic about the future prospects of such arrangements for solving debt problems. The staff could usefully elaborate on the future possibilities of such financing techniques. The consideration given by banks to interest capitalization is another new development that deserves encouragement.

Despite the new modalities, there has been some reluctance by banks to participate in concerted lending over the previous year. This lack of cohesion among banks is disturbing, as many of the packages that are being arranged have the solid support of appropriate adjustment policies, and in most cases Fund assistance is being provided. However, I agree that in many cases the major hurdle is ensuring the participation of banks with smaller exposures. This is admittedly a difficult issue to address and is one that must be resolved by banks themselves. To some extent, of course, it is better to have a limited number of banks to deal with. However, I agree that it is not easy to decide on the cutoff point of participation. Indeed, there is some hope in this respect with the emergence of the new financing techniques that I mentioned to encourage smaller banks to meet their obligations to any arrangements of new money packages. Such techniques could include a debt swap or a discounting loan/equity concession of the kind that is operating successfully in Chile.

As to the impact of the banks' supervisory practices on lending to developing countries, I see the merits of more detailed procedures for assessing commercial banks' capital adequacy that assign different risks to various types of assets. However, some difficulty could arise when a different risk weight is applied to governments in developing countries if such a procedure took the easier route of adopting the Fund's country classifications for this purpose. This is not the appropriate way in which to proceed, because, as the staff has rightly said, the Fund's classification system is devised only for the purpose of economic analysis and not with a view to prudential concerns.

However, it is still important for supervisors to stress the value of applying banking regulations in a flexible manner, taking into account in practice the adjustment programs and the quality of the policies in individual countries. However, creditors as a whole will contribute in a very important way to solving the debt problem facing developing countries by refraining from introducing protectionist measures and by opening up their markets to the exports of the developing countries.

In the area of the Fund's role in the debt strategy, there has been some welcome differentiation in the terms of Fund assistance. It is of course difficult at this time to generalize the experience gained by the Fund's enhanced surveillance procedure, but in general this practice has been an efficient mechanism for encouraging multiyear rescheduling arrangements and for facilitating a return to market access. However, I am not sure at this time how the Fund can address effectively the need for commercial banks to have an input in a country's adjustment program. In this connection, encouragement to banks to seek such policy performance by the debtor countries should be given with care in order to avoid any inconsistencies or conflicts in policies that might arise under the enhanced surveillance procedure.

Mr. Wijnholds made the following statement:

The staff paper contains a clear description of recent developments in international financial markets. It highlights the so-called securitization and increase in interbank activity that have recently been important features of international financial markets. The explosive growth of international bank lending subsided after 1981 to an annual rate somewhat below 10 percent, with the growth of such lending to developing countries shrinking to a rate of no more than 2-3 percent--or perhaps even less--during the previous two years. Mr. Ortiz mentioned that international bank lending to developing countries in absolute terms fell from $80 billion in 1981 to $9 billion in 1985. While I agree with him that this latter figure is too low, I hope he agrees with me that the figure for 1981 was not sustainable. Concerted lending was considerably smaller in 1985 and in the first half of 1986 than in 1984, but the successful completion of the Mexican package would of course raise the figure for this year significantly. An interesting and positive feature was the adoption in 1985 of what the staff calls "semispontaneous" packages for a number of smaller countries. Another interesting but possibly disturbing development that is briefly mentioned by the staff is the larger increase in deposit taking from nonbanks in developing countries, which increased sharply in 1985 and which could indicate some increase in capital flight. A sizable amount of deposits was withdrawn during the first quarter of this year. However, in the staff paper on international banking activity in the first quarter of 1986, these withdrawals were said to have been made largely by oil exporting countries on account of the fall in their revenues. I would be interested to hear from the staff whether it is the staff's impression that capital flight has been decreasing or increasing this year.

In commenting on developments in the debt situation, the staff rightly pays considerable attention to the various considerations of commercial banks with respect to new lending to countries with debt problems. In this connection, I share the concerns of the staff about the cohesion within the banking system that is clearly necessary to implement successfully new packages of concerted lending, the need for which unfortunately has not yet been eliminated. It will of course be primarily a matter for the banks themselves to agree on acceptable burden sharing schemes. It is conceivable that banks' contributions to future packages will consist of new money and take other forms as well. Mr. Ortiz has also referred to this matter. In addition, one of the possible ways in which to deal with the problem of smaller banks' participation might be the use of debt/equity swaps. There might also be a role for national supervisory authorities, in the sense that they could, if necessary, remind the banks of their response to the Baker initiative. I wish to take this opportunity to reconfirm my authorities' support for the Baker initiative. Although it is taking time to implement this approach, we should not let impatience push us to adopt schemes that would lead us away from the case-by-case approach.

The most important factor in determining banks' willingness to provide new credit remains the economic policies of the debtor countries themselves--both macroeconomic and structural policies. It is clearly of great importance that such policies contribute to halting capital flight. The Fund's involvement with debtor countries' policies is one element of the central role that I continue to see for the Fund in addressing the debt situation.

Another aspect of this central role is the Fund's intermediation in bringing about concerted lending packages. The World Bank's role in relations with commercial banks is mainly that of a catalyst for so-called managed loans in which large banks participate on a more voluntary basis. In this connection, I share the staff's concern about the introduction of new rigidities and cross-conditionality in cases in which commercial bank lending is made conditional simultaneously on both Fund drawings and World Bank disbursements.

In the area of rescheduling, there is a tendency for both commercial banks and official creditors to exert a stronger influence over debtor countries' economic policies by agreeing to serial multiyear rescheduling arrangements under which annual rescheduling is made dependent on annual policy programs. The banks' unwillingness to provide finance to countries with an insufficient adjustment effort is fully understandable, as is their condition that a new Fund arrangement is needed before restructuring can be continued in such cases. However, as the staff correctly notes, the appropriate type of Fund involvement has to be decided by the Executive Board. I do not wish to comment in detail on enhanced surveillance at this meeting, except to say that our practices in this area are still evolving and that adaptations might have to be made as we gain experience. The staff mentions that banks had--at the time of the writing of the staff paper--not yet received any Article IV consultation reports under the enhanced surveillance procedure. I can now report that in the meantime the latest report for Yugoslavia has been distributed to the banks.

Returning now to supervisory matters, I wish to make some remarks on provisioning. The staff reports the banks' feeling that the practice of requiring so-called basket provisions could hamper a return to spontaneous lending, which would not be the case if provisioning were based on an individual assessment of country risk. In countries such as the United States and the Netherlands, such specific individualized provisions are required by the supervisory authorities. In the United States, only limited use has been made hitherto of this instrument.

While the matter of diverging supervisory practices can be a complicating factor in a return to spontaneous lending, and while I agree that individualized specific provisions against country risk are to be preferred to "basket provisions," they should not be considered as a fully convincing excuse for banks to refrain from new lending in cases in which sufficient adjustment efforts are being undertaken. In DM/86/42, entitled "Provisioning, Charge Offs and the Willingness to Lend," the authors have incorrectly included the Netherlands among the countries with a basket approach to provisioning. I am not convinced that the authors' view that the greater the banks' willingness to take part in bail-out loans the higher their exposure leads to useful conclusions about provisioning policies. In addition, the authors have wrongly described the causality involved in stating that "the mandatory provisioning requirements adopted by the supervisory authorities in most creditor countries are among the many factors that have increased the perceived risks and costs associated with new loans to developing countries." In my view, perceived risk leads to provisioning and not vice versa. An essential point here is that the freedom of choice regarding the valuation of assets assumed by the authors does not actually exist.

In its latest paper the staff has added a useful section on foreign investment. The reasons provided by banks for the attitude of their corporate clients concerning such investment are interesting, as is the fact that the changes that are now being envisaged in some host countries could positively influence the attitude of potential corporate investors. The establishment of the MIGA and the work being done by the IFC should help to promote foreign direct investment and portfolio investment in developing countries. Stock exchanges in some developing countries have shown impressive gains recently, and foreign investment could be attracted in increasing, albeit modest amounts. Another positive development is the conversion of debt into equity, which particularly in Chile has assumed significant proportions. In sum, such activities are not likely to have a major impact on the situation of debtor countries, but they nevertheless deserve to be encouraged, so that together with other actions they could help to alleviate the debt problems in various countries.

I would like to make two points on the subject of recent innovations in financial markets. The first is that while developing countries with market access could conceivably benefit from some of these new techniques, we should not raise our hopes too high. Only countries with a sound record are likely to profit; therefore, I agree that rebuilding creditworthiness has little to do with the use of innovative financing techniques. Second, while such innovations might improve market efficiency, problems associated with the increased complexity and lack of transparency of markets should be closely monitored. I agree with the staff's observation that the far-reaching integration of financial markets necessitates an increase in international coordination in the areas of supervision and macroeconomic policies, with Fund surveillance playing an important role in the latter. Indeed, this conclusion could also be drawn from the report of the G-10 Central Banks Study Group chaired by Mr. Cross.

Mr. Nimatallah made the following statement:

I welcome this opportunty to examine recent developments in the capital markets. I see two purposes to this annual exercise as they relate to the Fund. One is to assess the state of international liquidity, and the other to evaluate the capacity of the Fund to catalyze financing in support of members' adjustment programs.

I wish to begin by examining the state of international liquidity. The facts are clear. First, bank credit and bond financing in 1985 and the first part of 1986 have continued to increase at a high rate for industrial countries but at much lower rates for developing countries. Second, looking at developing countries by region, it is clear that developing countries in Asia were able to increase their borrowing, not only through bond markets, but also through spontaneous commercial bank borrowing. Third, official and multilateral lending and debt relief have been moving in the right direction. In 1985, about $20 billion was extended to developing countries, more than twice the amount committed by the private capital markets. Fourth, there have been some further changes and innovations in the capital markets that might have some far-reaching implications for financial relations among participants in those markets. Markets have continued to become more integrated and to enjoy more liberalization, to the point that boundaries are becoming less clear. Another development is the increase in risk unbundling and the growth of hedging instruments. Above all there is a clear trend toward securitization. I am surprised to read at the top of page 33 of SM/86/201 that in the first half of the 1980s the share of market debt in total new international credit jumped from about 30 percent in 1980 to about 70 percent in 1985. What are the implications of these facts that are reported in the staff papers? As I see it, the fact that some developing countries in Asia and Europe have had better access to capital markets is instructive. It indicates the countries that have shown persistence and continuity in their adjustment efforts have found it easier to gain access to capital markets. In other words, debtor developing countries need to be persistent in their adjustment efforts to regain access to spontaneous credit. Debt servicing naturally requires additional, persistent efforts toward adjustment and growth. Economic growth is the key to enabling debtor countries to service their debt.

The further changes and innovations in the capital markets have many implications, especially in two areas. One is on the efficacy of the implementation of monetary policies in the industrial countries, and the other is on the quality of supervision over banks. However, I am pleased to see efforts directed to alleviating these two possibly adverse effects. One effort is expressed in the report that was released in March 1986 by the Committee on Banking Regulations and Supervisory Practices, in Basle under the title "The Management of Banks' Official Off-Balance Sheet Exposures: A Supervisory Perspective." The other effort is expressed in the Cross Report that was released in 1986 to evaluate recent innovations in international banking and to consider how to improve the quality of supervision. The first report identifies the need for the so-called risk asset ratio, in addition to factors determining capital adequacy itself. The Cross Report identifies the trend of credit flows being channeled increasingly through capital markets, rather than banks, which could make the international banking system less responsive to sudden increases in liquidity demand and less able to withstand shocks to the system. Therefore, the Cross Report notes that central banks might have to extend their responsibility to include nonbank financial institutions. These efforts are in the right direction and should be further pursued.

Now I come to the responsibility of the Fund vis-à-vis its members. Let me start with the elements that the Fund should normally take into consideration as it assists its members. One should be the serious adjustment efforts and the adequate programs that members adopt in coördination with the Fund to carry out adjustment. The other is debt relief from both official and commercial creditors. Yet another is to secure new money or fresh resources, perhaps from official and/or commercial creditors in addition to access to Fund resources. Of course, an important element is the international environment, which can facilitate trade and sustain reasonable, well-coordinated interest and exchange rates.

Which features of the recent developments in capital markets should the Fund be concerned about? In my judgment, the first element, adopting and sustaining adjustment policies, should be emphasized much more today than at any other time. The indications from the assessment of the capital markets' performance are that countries that need to adjust should continue their efforts without interruption and should design with the Fund, and perhaps with the World Bank, growth-oriented, comprehensive adjustment programs.

Debt relief has, in general, been moving in the right direction through restructuring by the debtor countries that have adopted macroeconomic and structural adjustment programs with the Fund and the World Bank. Official debt relief, in particular, has begun a new, promising era with the negotiation of multiyear rescheduling arrangements with two countries, Côte d'Ivoire and Ecuador. Commercial banks should perhaps be more flexible, particularly if countries continue their adjustment efforts.

There is some evidence of strain in capital markets in providing developing countries with new resources, perhaps because of a lack of progress of debtor countries, in particular, in restoring creditworthiness as perceived by the banks. It could be due to a lack of cohesion among members. But it could also be due to the increasing trend of securitization in the capital markets or to a combination of all these and other factors. This calls for efforts by all parties concerned to reduce these strains in capital markets. In this respect, the Baker initiative is relevant, as it attempts to convince the banks to be more forthcoming and responsive to the needs of countries that adopt sound adjustment and growth policies. I am pleased that Mexico is being considered as the first major case under this initiative. However, as I understand it, there are difficulties in assembling the required commercial bank financing package for Mexico. I hope that this and other cases in the near future will find the capital markets more responsive.

In my judgment, it is important at this stage to emphasize other means of increasing funding within such packages. I have in mind two sources in particular--direct and portfolio investment on the one hand, and commitment to structural adjustment that brings additional resources from the World Bank and other multilateral institutions on the other. I am pleased that progress is being made in several debtor developing countries to encourage direct and portfolio investment, and the establishment of MIGA has been a step in the right direction. It is hoped that the growth and interest in MIGA will foster increased direct investment flows, and the efforts of the IFC in that direction are commendable. However, I hope to see more progress in efforts directed toward discouraging and, indeed, reversing capital flight. The facts show that there is a substantial potential for increasing nondebt-creating flows to developing countries.

If it continues to be difficult to raise new resources in the capital markets for packaged financing, then Fund resources might have to play a larger role. This means that access limits to Fund resources might have to be more flexible in the near term, in order for the Fund to play its catalytic role more effectively, thereby ensuring that the needed adjustment efforts are made. Of course, the Executive Board will return to this issue soon.

The final element that is of considerable importance in helping Fund members to implement successfully their adjustment efforts is an appropriate international environment. Here, I would emphasize that international trade should not be hindered by any barriers. Exports of developing countries should be encouraged, and protectionist pressures against them should be resisted. At the same time, the developing countries themselves should be encouraged to practice freer trade. Furthermore, while there has been an improvement in coordination on exchange rates and interest rates among the large industrial countries, more needs to be done to reduce severe fluctuations in these two areas. Lower interest rates, together with lower oil prices, have certainly given adjusting countries, particularly fuel importing debtor countries, more opportunities to intensify their adjustment efforts and to emphasize growth.

On the basis of these considerations, I have reached five conclusions. First, it is important to look again to see whether the present level of official influence on capital markets is effective enough to ensure the efficient allocation of resources to countries that prove to have a need for them. Second, debtor developing countries, in particular, need to make convincing efforts and show continuity in carrying out their adjustment. Third, for their part, the industrial countries need to continue their efforts to coordinate their macroeconomic policies and to resist and reverse protectionist measures. Fourth, the Fund should be aware of changes and shifts in capital markets and should be prepared to respond to them in a timely and appropriate fashion that would be helpful to its catalytic role. Fifth, the World Bank should continue to coordinate with the Fund to help its members to carry out comprehensive structural adjustment policies in conjunction with other multilateral and regional institutions as well as other creditors.

Mr. Schneider made the following statement:

Clarity and completeness are the outstanding features of the annual analyses by the staff of capital markets over the previous several years. Rereading these analyses shows clearly how the emergence of the international debt problem as a global threat to the stability of the world financial system has dominated developments in the international capital markets. Those developments have led to a compartmentalization in the international capital markets as a whole. First, the financial flows between industrial countries have continued to develop at an unprecedented rate, in contrast to flows toward and among the developing countries, which have shrunk or dried up altogether. Second, a split has divided the recipients of the few remaining flows from the industrial countries to the Third World more or less into two groups--a few heavily indebted middle-income developing countries still receive modest amounts to enable them to service their debts because their potential default is a real threat to the stability of the industrial world's capital markets, while many low-income and some smaller, middle-income developing countries are more or less completely excluded from the international financial markets and therefore have to rely almost entirely on concessional aid to finance their development efforts.

The industrial world enjoys increasingly integrated and sophisticated capital markets concentrated in a few major financial centers. In all these centers, the general trend toward deregulation, the widespread use of new technologies, and the continuing flood of financial innovations are to a greater or lesser degree conferring such benefits as reduced financing costs, better arbitrage between different geographical markets and different instruments, and increased possibilities of risk hedging. These advantages in turn permit a more efficient allocation of financial resources. Furthermore, additional efficiency gains in the international financial markets could be expected if the fiscal and external imbalances in the United States could gradually be adjusted, which would in turn lead to more stable exchange rate relationships.

In addition to benefits, however, the new integration and sophistication of the principal financial markets also involve a number of risks, which are well explained in the staff paper. The major issues are the inadequacy of the pricing of the risks that are inherent in financial innovations, the potentially overestimated liquidity of some financial assets, and the lack of transparency that has been exemplified by the rapid expansion of banks' off-balance sheet activities. Although these risks have aroused serious concern in the financial community, it is probably true that the currently improving capital structure of the international banks, the general awareness of these dangers, and concerted preventive actions against them by the regulatory authorities are defusing the systemic risk and are ensuring greater stability and efficiency of the international financial system.

Although the diversification of financial instruments can be judged a positive development, because competitiveness in the financial markets as well as the efficiency of resource allocation have been improved, it also raises important questions with respect to the future role of the commercial banks in channeling resources from surplus countries to deficit countries and the financing prospects of the developing countries themselves.

On page 6 of the main paper the staff reports the feeling shared among market participants that the present diversification results at least in part from a process of disintermediation triggered by the preference of large deposit holders for acquiring assets directly from prime rate borrowers rather than for holding deposits in banks whose balance sheets are burdened with claims on high-risk countries. If confirmed, this trend would have important implications for the prospects for future lending to developing countries and would raise the question whether traditional lending practices can suffice to restore financial flows to developing countries at an appropriate level.

Current developments suggest that this might be the case. Commercial banks might well continue to concentrate new lending on a few heavily indebted developing countries while excluding most others from access to foreign borrowing. How to overcome this division of the market between different groups of borrowers while promoting a general increase of financial flows to developing countries in line with the thrust of the Baker initiative is the major challenge facing the international financial community.

The possibility to meet this challenge exists. Some of the new financial instruments and techniques could, if applied more generally, help to heal the aforementioned divisions in the international financial community. For example, the technique of equity/debt swaps is of particular interest because although it was designed primarily to reduce the debt burden, it could also be used as a growth instrument. In addition, other kinds of swaps--for example, debt, interest rate, or currency swaps--capable of relieving or better distributing the debt burden could be carefully examined and, where appropriate, actively implemented.

There are other financial devices that are especially well suited to the task of initiating and accelerating the re-entry of some countries into the international financial markets. The issuance of short-term financial instruments should be actively supported by various systems of official guarantees or cofinancing mechanisms. Some of the investment initiatives of the multilateral agencies, particularly the IFC, and the commencement of operations by the MIGA, will undoubtedly ease these countries' passage through this critical stage of development, and for this reason they deserve our attention and encouragement.

There is a multitude of financial techniques requiring further study in this light. For example, I was greatly interested to learn from the staff paper that investors in some financial centers are interested in the notion of making portfolio investments in a limited group of developing countries as a part of a general diversification strategy, an interest that has been demonstrated by the success of the Korean equity in Japan and the launching of an equity mutual fund for India. Multilateral institutions like the IFC can help to establish the necessary capital market and legal structures and could further assist by disseminating information as proposed in the staff paper. Some sort of financing program having these ends in view could be contemplated.

Besides these helpful developments in the markets, concerted lending to help finance the re-emerging balance of payments problems of the heavily indebted countries will continue to play an important role. For this reason I was concerned about the staff's report on its discussions with the commercial banks, which indicates a general trend toward greater reluctance and operational difficulty in putting together money packages. I hope that the financial package negotiated with Mexico will have a catalytic role in this respect. Such an outcome would also demonstrate how the Fund can reinforce its role in the debt strategy by designing programs that allow for more flexible financing from commercial and official sources and by committing a more substantial share of its own resources.

Mr. Fujino made the following statement:

The staff's analysis of the recent trends in international lending through bank and bond markets illustrates the developments and problems that are emerging in the markets. While there was a rapid increase in total net lending through international bank credit and bond markets to $310 billion in 1985, total net lending to developing countries continued to slow, to $19 billion, even after taking into account the doubling of bond issues in 1985 compared with 1984. One of the key developments in the international capital markets in 1985 was the vigorous expansion of activity in international bond markets, which was associated with the general trend of securitization as well as the active use of innovative techniques, including swaps and note-issuing facilities. Bond issues by industrial countries grew by 50 percent in 1985 and continued to grow during the first half of 1986. Another noteworthy development is the rapid increase in interbank lending to and deposit taking from Japan from a negligible figure in 1982 to $42 billion in 1985. As the staff notes, this is one indication of the rapid liberalization of the Japanese market and its integration with the international financial system. The Tokyo offshore market, which is to be established toward the end of 1986, will further facilitate the growth of international transactions through the Tokyo financial market.

Developing countries benefited to some extent from the growth of international bond markets in 1985, with bond issues to these countries doubling to $10 billion in 1985. However, only a small number of developing countries from Asia and Europe accounted for 80 percent of the total value of these issues; during the first half of 1986 bond issues by them fell to a level that was only slightly higher than that of 1984. Most countries have failed to exploit the full benefit of the expansion of the international bond markets.

Bank lending to developing countries was almost stagnant in 1985, representing a long-term "healing process," to use the expression in the staff's paper. Since the debt situation had passed the crisis stage, banks apparently were shifting their attention to new sources of profit, particularly to those that I have mentioned. Of course, there is a serious question whether the banks' wounds could be healed before the debt problem itself is solved. The general lack of enthusiasm by banks to providing necessary financing to developing countries could lead to a delay in adjustment and could well prolong the healing process of the banks themselves. The increase in lending by Japanese banks could be explained to some extent by the increase in lending to Asian countries with strong regional ties. Despite these increases, Japanese banks were not without problems. The balance of payments position of Japan does not necessarily contribute to the lending decisions of commercial banks, and it is important to improve further the lending climate. I would underscore the importance of the adjustment efforts by debtor countries themselves and successful demonstrations of progress in this regard as a precondition for credit flows from commercial banks. Another important factor on which banks' attention is increasingly focused is the continued outflow of private capital from debtor countries. The general reluctance of banks to provide increased credit flows stems at least partly from the perception that such credit might be used to finance capital outflows. It would be difficult to expect an increase in commercial bank lending to a country where private citizens seek to place their funds abroad owing to their lack of confidence in their economy.

The weakening of cohesion among banks in responding to requests for restructuring and concerted lending is a cause for serious concern. It is important for the advisory committees to try to remove uneasiness and suspicions held by banks about the behavior of other banks and to eliminate the dissatisfaction that arises because their views are not taken into account by providing sufficient information quickly and on an equitable basis and by opening up channels of communication among banks. In addition, it is important to achieve an equitable burden sharing within the banking community. It is true that there is a difference between the exposure that is currently used as a base for new money packages and the real exposures that exist now. This difference is caused by the fact that since the base date when debt servicing difficulties emerged for each country, banks have provisioned against their exposure to a different degree and at a different pace, and some of them have even sold their claims. However, I share the concern that a shifting to a later base date that reflects more fully the banks' current exposure might send the wrong signals by penalizing banks that have cooperated and contributed to spontaneous increases in exposure and by legitimizing the withdrawal of others.

The staff notes that in light of the diminishing bank cohesion, some banks favor the introduction of more flexible financing techniques, such as "interest capitalization." However, it is not clear how such techniques would be combined with the present method of concerted lending. Moreover, interest capitalization in particular could have serious implications for debtor/creditor relationships and for future lending to debtor countries. Therefore, I believe that we must be very cautious in dealing with such a technique.

Semispontaneous lending has been devised and applied to countries with a good record of adjustment in the hope of facilitating the process of restoring normal market access for these countries. However, in the cases in which banks were more or less obliged to participate in such lending schemes to close a financing gap it was not clear to what extent spontaneity existed. There may be a risk that the situation might be more complicated by the appearance of spontaneity. Furthermore, such lending could complicate the burden sharing among banks, if and when further concerted financing should prove to be necessary. At the same time, banks have shown a strong interest in cofinancing arrangements with multilateral development banks. While the World Bank's involvement should not be seen as a substitute for the commercial banks' meeting their responsibilities, to the extent that such involvement encourages lending by commercial banks, it could be considered to be an important step toward the restoration of a normal relationship between debtors and creditors.

The staff paper indicates that there has been a shift to short-term trade financing and project financing. Nevertheless, general purpose balance of payments support from banks would still play an important role and would not be fully replaced by such financing. Therefore, caution will be required against too much and too rapid a shift by banks toward these types of financing. Indeed, in implementing Secretary Baker's new initiative on debt, both official and private resources have to be increased together in a balanced manner.

The Fund will continue to play an important role as a catalyst, a provider of required financing, and in assisting members to design growth-oriented adjustment programs. With respect to enhanced surveillance, a sharp decline in oil prices has significantly altered the economic conditions of three countries to which the procedure has been applied. While this has made the general assessment of the procedure extremely difficult, the variability of economic conditions underscores the need for some caution against its widespread application.

There is ample scope for improving the environment for direct capital investment in developing countries. For a limited group of countries there might also be an untapped source of funds in the form of inward portfolio investment. In this connection, the success of the scheme of debt conversion into equity in Chile and other countries is welcome, and I hope that there will be further developments in this direction.

Continued structural changes and innovations in financial markets call for a careful and close examination of these developments by the international financial community as well as national supervisory authorities. We have a comprehensive report by a study group chaired by Mr. Cross, and I welcome the update of recent developments in the staff paper.

Mr. Goos made the following statement:

It is impossible to do justice to all the many issues that are raised in the staff paper. I will concentrate my comments on international bank lending to developing countries, together with recent trends in capital market innovations and official multiyear rescheduling arrangements.

I share the concern expressed by previous speakers about the continuous decline in bank lending to developing countries in recent years. Until the end of 1985, one could have taken some comfort from the observation that the decline in bank lending had been accompanied by rather pronounced additions to international reserves, implying perhaps that the overall liquidity constraint facing developing countries was less severe than was suggested by developments in international bank lending alone. This conclusion also seems to be borne out by the rather high level of cross border bank deposit taking from capital importing developing countries, which averaged approximately $20 billion over the past two years. Of course, this indicator could be less reliable or telling to the extent that such deposit taking might reflect capital flight from those countries, which apparently increased in 1985. Considering the latest information on international bank lending, which shows that such lending to developing countries even turned negative in the first quarter of 1986 while those countries drew heavily on their holdings with international banks, this development, if maintained, would indicate a considerable tightening of the external financial constraint on developing countries. This constraint would become all the more pronounced if the weakening of the current account positions of virtually all developing country groups projected in the latest world economic outlook paper should materialize. Of particular interest--and particularly worrying--in this connection is the observation that international bank lending to heavily indebted developing countries, after having stagnated in 1985, has also turned negative in the first quarter of 1986.

These developments, despite the considerable uncertainty surrounding the accuracy and reliability of international bank lending data, raise difficult questions with respect to the objective of ensuring an appropriate flow of resources to developing countries and with respect to the functioning of the existing debt strategy. Although it might be premature to draw definite conclusions for the remainder of 1986 and beyond, the staff papers and the projections in the latest world economic outlook paper appear to offer little cause for complacency. Indeed, it is most disquieting to note from the staff's discussions with leading commercial banks that "while supporting the broad objectives of the Baker initiative [they] were adopting a wait and see approach with regard to its implementation." At the same time, it appears that a growing share of new bank lending to developing countries is being covered by new official export guarantees, and that banks increasingly are attaching strings to their disbursements in the form of prior actions by other creditors, including the Fund. This approach of the banks is certainly difficult to reconcile with the high degree of responsibility that they have within the debt strategy. Moreover, it is all the more worrying given the fact that the cohesion among the banks that are exposed to heavily indebted countries appears to be wearing thin while the discussion among banks on how to maintain that cohesion has not advanced significantly thus far.

Despite these reservations about the behavior of commercial banks, it would be unfair to blame only the banks for the ongoing decline in international bank lending and for the delay in a more forceful implementation of the existing debt strategy. Given the commercial character of the banks' business, it is understandable that they make their lending contingent upon satisfactory economic policies and prospects of recipient countries and hence on their ability to service outstanding and newly acquired debt. While banks in general appear to have acted consistently with that basic philosophy, as they have honored convincing adjustment efforts by granting debt restructuring and by providing new money, one has to acknowledge that adjustment efforts of a number of countries, including several of the heavily indebted countries, leave much to be desired. Moreover, the economic prospects of developing countries, including those with a satisfactory adjustment record, are being marred considerably by the widespread weakening of their export earnings and terms of trade and the resulting adverse impact on their external creditworthiness. It is telling that for capital importing developing countries the rate of growth of export earnings has remained consistently below the interest rates paid on their average outstanding debt in recent years, and that this relationship will probably continue in the foreseeable future.

From this I would conclude that the recent unsatisfactory experience with international bank lending to developing countries, rather than indicating a fundamental deficiency in the existing debt strategy, strongly suggests that all the participants in the debt strategy should strengthen their efforts to provide an adequate flow of resources to developing countries and to ensure that they are used in the most productive way. While the Fund and the World Bank appear to be on an appropriate course--although a timely decision on the next capital increase and on an adequate replenishment of IDA would be helpful--there is a clear need for many developing countries to strengthen further their adjustment efforts particularly by intensifying supply-side oriented structural reform as well as by creating a more favorable environment for attracting direct foreign investment and recovering flight capital. At the same time, industrial countries are called upon to create the necessary conditions for more buoyant international trade, thereby improving export prospects of developing countries. International banks have a particular responsibility for ensuring an adequate flow of resources to developing countries--a responsibility that would require much stronger efforts than hitherto aimed at inter alia ensuring the participation of banks in lending packages and a quicker and perhaps bolder response in their lending decisions to the adjustment efforts of developing countries. I agree with previous speakers that the task of finding appropriate solutions to those problems has to be left to the banks themselves.

However, there are several indications in the staff papers that other players in the field of international lending should also play a more active role. Without going into great detail, I would mention in particular the apparent need to narrow the divergence in national supervisory and accounting regimes while securing a sufficient degree of flexibility with respect to provisioning. Another area that warrants immediate attention is the unsatisfactory performance of official lending. This form of lending will probably have to assume a much greater role, particularly in the poorer primary producing countries whose creditworthiness with respect to commercial lending appears to have considerably weakened in the wake of the continuing decline in important commodity prices.

While this list of requirements for the unlocking of a more appropriate flow of resources into developing countries, including the highly indebted ones, might appear to be demanding, I feel strongly that there is no realistic alternative to the existing strategy. It seems to be reassuring that substantial progress has been achieved since 1982 in improving critical capital and exposure ratios with respect to claims on developing countries in banks' balance sheets, that spreads on lending to developing countries have narrowed, that maturities of such lending have lengthened, and that the banks are apparently looking for more flexible forms of lending tailored to the specific circumstances of individual countries. These developments, as well as the encouraging progress in bringing together a financing package for Mexico, appear to bode well for the success of the present debt strategy.

During last year's discussion on capital markets, I expressed a number of serious concerns about the process of innovations and structural changes in the international financial markets. Without repeating those concerns, which I continue to feel, I am reassured that they have been addressed in the Cross Report, "Recent Innovations in International Banking." However, I hope that the relevant official bodies, including supervisory agencies and monetary authorities, will draw the appropriate conclusions from that report in order to contain the risks inherent in such innovations. Hence, I welcome the ongoing effort to increase transparency by improving and broadening statistical reporting. I agree that also the Fund, through its surveillance function, has to play an important role in this area with a view to ensuring orderly conditions in financial markets and improving global resource allocation.

My authorities warmly welcome the paper entitled "Multilateral Official Debt Restructuring," which is a unique and extremely helpful compendium on the debt restructuring activities of the Paris Club. While I generally agree with the presentation in the paper, especially with respect to the variety of restructurings agreed so far, and the flexibility of the Paris Club in finding solutions that meet the specific circumstances of individual cases, my authorities feel that in the chapter on the comparability of treatment the authors of the paper tend to overestimate the possibilities of the Paris Club to enforce such comparability. In many instances, the Paris Club simply lacks the ability to do so, particularly to monitor the compliance of debtor countries with comparability undertakings. In this respect, the Fund, through Article IV consultations and review missions, seems to be much better equipped for such a monitoring task than the Paris Club. At the same time, however, strict adherence to the principle of comparability does not always seem to be necessary or appropriate in the view of my authorities. Accordingly, as is indicated in the staff paper, there has been a number of cases in which debtor countries did approach only certain groups of creditors for debt restructuring. In some cases, such selective requests for rescheduling were often addressed to banks alone, with a view to maintaining export credit coverage from official creditors.

I have received from my authorities a number of comments of a more technical nature regarding the presentation in the staff papers. I will convey those comments to the staff on a bilateral basis.

Mr. Foot made the following statement:

The staff papers cover a wide range of issues, and in my comments I will concentrate on the progress that has been made with the debt strategy. This will not do justice to some of the interesting background material presented by the staff, but it does provide a focus for the consideration of a number of policy issues.

With respect to the commercial banks, the staff papers provide details about what we all know has been a far from easy year. In SM/86/193 the staff notes that the banks' attitude toward further financing remains critically related to the pursuit of sound macroeconomic and structural policies in borrowing countries.

But the path of adjustment in many of these countries has been difficult, and it is therefore not entirely surprising to note the staff's conclusion that "spontaneous private credit flows to developing countries are expected by banks to continue at a low level in the near term." In addition, the paper warns that the "mustering of concerted financing may be more difficult in the period ahead as bank cohesion is diminishing." While I can see why these remarks are made, I think that it would be wise not to be unduly pessimistic. There have been a few cases--Ecuador is the latest one to come to the Executive Board's attention--in which spontaneous new bank financing has been possible despite a significant deterioration in the external environment of the countries concerned because the banks perceived and responded to the countries' track record and to the will to adjust of the authorities concerned. There have also been cases in which new lending has been arranged on a less than spontaneous basis. If in the coming few weeks a satisfactory outcome to Mexico's current negotiations with the banks can be reported, one could reasonably conclude that there was still life in the overall concerted financing effort. There were numerous cases in which banks rejoined in rescheduling without providing significant amounts of new money in order to give debtors a needed breathing space. In sum, the picture with respect to commercial banks is not as bleak as the figures alone might suggest. While I would not be complacent--creditors are subject to adjustment fatigue just as debtors are, and there are genuine problems in such areas as the treatment of smaller banks--I nevertheless remain hopeful.

The pace of adjustment by the main debtors has been diverse, and the external conditions that they have faced have often been difficult. But I draw some encouragement from the slowly spreading realization that direct and portfolio foreign investment often have considerable advantages over external bank financing. It is important for debtors to do more than they have thus far to encourage new inward investment both by reducing restrictions on such investment and, where appropriate, by using equity/swap arrangements. I recognize that the contribution from such arrangements is likely to remain fairly modest. There have been some encouraging developments on the side of investors--for example, the establishment of the MIGA and interesting innovations by the IFC, most recently with respect to the guaranteed recovery of investment.

It is also important to continue addressing the problem of capital flight. I recognize that there are difficulties in defining and measuring this concept, but the problem clearly exists. Sound fiscal and monetary policies are required to curb capital flight. It is certainly not the job of the foreign commercial banks to stop the nationals of any country from exporting capital from their country. The prime responsibility for that rests with the authorities of the country concerned. Therefore, I welcome the staff paper on this subject that was recently distributed, which is thought provoking and suggests a number of possible lines of future work by the staff.

Developments in 1985 with respect to official creditors' handling of rescheduling were encouraging. Not only did the number of reschedulings and amounts rescheduled reach record levels in 1985, but also, as the staff has shown, official creditors demonstrated a greater willingness within a generally agreed framework to provide the help needed by particular countries in a positive and rapid manner. An example of this is the treatment of Zaïre by the Paris Club. In that case, a rescheduling agreement was quickly reopened and made more favorable to Zaïre when an unexpected financing gap appeared. This was Zaïre's eighth rescheduling agreement with the Paris Club and it was completed well within the 30 days that the Executive Board had given for the financing gap to be closed, so that a pending stand-by arrangement could become operative. Of course, more could be done in the development of the Paris Club's procedures. Restructuring by an international group--and a rather ill-defined group at that--was at least as difficult as restructuring a member's trade policies or parastatal sector. The Paris Club has gone a great distance in a very practical and positive way to making needed changes.

A similar degree of positive and innovative thinking has taken place in the major international financial institutions. In the Fund, this cannot be measured by the number of cases of disbursed assistance, but it is nevertheless evident. As for other institutions, SM/86/208 shows that such an attitude has been responsible for placing total commitments on a significantly rising trend; that trend would have been more clearly established if the partial data for 1986 had been available for the staff's use. There has been a general willingness to examine ways in which to improve the lending operations of these institutions, and this bodes well for the future.

There are three issues that are particularly relevant to the Fund. The first is raised on page 21 of SM/86/193 and follows from the fact that commercial banks have increasingly linked their disbursements of concerted lending to the implementation of programs supported by the Fund and the World Bank. My authorities have no problem with banks seeking what they feel is reasonable protection, but in some cases, as the staff has noted, this action appears to have led to the inclusion of clauses in rescheduling agreements that appear to precommit the use of Fund resources or the enhanced surveillance procedure. It is my understanding that in several cases these clauses have been modified after discussion with the Fund, and I am confident that it is widely agreed that the Executive Board will not be bound by such conditions. Nevertheless, I would be interested to hear from the staff whether it feels that this is merely a transitory problem that will diminish because the banks understand better what the Fund does or whether the staff feels that some initiative by the Fund is called for.

A second issue is the adequacy of the statistics that the Fund is given on commercial bank activity. As the staff has correctly noted, given the furious pace of current innovation, especially with respect to securitization, it is increasingly difficult to know who is holding whose debt. But I understand that several major capital exporting countries publish only a few or no statistics on the geographic distribution of their banks' lending. While this is partly remedied within the BIS and elsewhere, I wonder if such remedies are sufficient.

I agree with previous speakers that this is not the proper occasion for a detailed discussion of the third issue that I have in mind, namely, the experience to date with the enhanced surveillance procedure. It is clearly too early to reach a considered view on that experience. However, the staff reminds us in its review of this subject that the main purpose of enhanced surveillance is to facilitate the return to normal market access through a multiyear rescheduling arrangement for countries that have a good adjustment record. If developments frustrate this purpose, either because the country under surveillance shows no will to introduce appropriate policies, or because correct use is not made of the Fund's advice, it seems to me that a major question must be raised about continuing surveillance of that member. Mr. Wijnholds has noted that the staff reports for Yugoslavia have already been passed on to the commercial banks, but none of the three reports on Venezuela that have been discussed in the Executive Board have been distributed to creditor banks, as the multiyear rescheduling agreement with Venezuela has not yet been implemented. This is a subject to which we must return.

My final point concerns financial liberalization. In its paper the staff has suggested that changes in the institutional structure of financial markets have both altered and diminished the role of commercial banks. I agree with the suggestion, although it is difficult to know yet how much further the changes will go and whether all the changes will prove to be permanent.

I would advise caution in responding to the view expressed on page 27 of SM/86/193 that the concerns over developments in these markets "can be addressed by official action." It is undoubtedly true that various authorities are aware of the issues and are taking appropriate action in the fields of supervision and statistics, but this is far from saying that these authorities will be able to address problems when they arise and begs the question whether they even should do so. This a typical moral hazard issue that is far from being fully resolved. It would be wholly inappropriate in a published version of these papers to refer to possible liquidity support by central banks for nonbank financial institutions, as is currently the case on page 29 of SM/86/193. However, I strongly support the publication of these papers in the usual suitable form.

The subject of nonbank financial intermediation will undoubtedly be a feature again of developments in 1986. In preparing the next set of papers the staff could usefully explore some of the motivations of the commercial banks that are investing heavily in nonbank activities. This would help to shed light on the possible long-run implications of this trend for traditional banking.

Mr. Massé made the following statement:

It is obvious, in the context of the two major themes of the staff paper, namely, developments in the debt situation and changes in financial markets, that sound economic and financial policies are of primary importance. As the staff notes, a fundamental influence on banks' willingness to lend to developing countries is these countries' policies. However, it has been noted that bank lending might respond to the establishment of sound policies only with a lag. This should not be perceived as an indication necessarily of irrationality or market failure. Instead, this sort of behavior by lenders is more likely a result of considerations that are related to the sustainability of government policy and to the perceived prospects for particular countries' exports and economies.

As to the theme of the changes in financial markets, it is correctly noted by the staff that the market discipline that is necessary to appropriately price risks and allocate savings will operate more effectively in an environment of stable economic and financial policies. These considerations argue for macroeconomic policies that are characterized by consistency, stability, and a good deal of commitment to proper policies in a medium-term perspective.

The second area on which I would like to comment is the difficulty that is expected in mustering new financing packages. It seems that we could be facing a kind of race against time: as banks build up their provisions over time, with the encouragement of both their shareholders and regulators, new lending might be discouraged and the degree of commitment to past claims might decrease, so that mustering new financing, other things being equal, might become more difficult in the future. Simultaneously, the trading and rearrangements of banks' portfolios would also tend to diminish the degree of cohesion within banking groups. Together these developments threaten to erode a vital aspect of the debt strategy--participation by commercial banks. Over time, a greater number of banks might find it attractive to increasingly attempt to disengage themselves from troubled debtors, and banks with large uncovered claims would be in a difficult position, as would the countries that are dependent on such sources of finance.

This does not mean that banks should stop or reduce provisioning against their exposure. Instead, this risk re-emphasizes the need for sound and stable economic policies in a medium-term context. In addition, the Fund should recognize and analyze in depth the potential contribution that alternative modalities and sources of finance could make, such as the market discounting of debt instruments and the capitalization of interest.

In connection with the latter consideration, there would be merit in particular in pursuing development of debt swapping schemes, perhaps along the lines of the scheme that is operating in Chile. Such mechanisms could help to diversify the types of obligations and risk sharing arrangements of members and might provide some impetus for the repatriation of flight capital and for the generation of new finance. More generally, there is an important role to be played by multinational institutions like the Fund and the IFC in helping to develop appropriate investment techniques and instruments and in helping to develop domestic financial markets, particularly stock exchanges, that would facilitate a diversification of finance. However, in order to pursue successfully these options, it is absolutely essential that capital importing countries allow foreign direct and equity investment on a significant scale under attractive conditions; in particular, they should ensure that foreign investors have ready access to their investments and earnings. It is also absolutely essential that protectionist barriers to trade be avoided by all members. Provided that sound and stable policies are in place, such approaches might contribute over a longer period much needed sources of capital for many members as well as provide a necessary remunerative and productive outlet for capital exporting members' savings. The main objective of the strategy is to tackle the debt problem in a way that promotes growth in the world economy and avoids a disruption of global trade.

I will conclude with brief comments on recent innovations in capital markets and the rapid changes that are occurring in this area that have reduced the barriers between financial markets. The benefits of greater efficiency that result from a freeing and integration of markets seem to point in the direction of continuing to encourage the liberalization of these markets. In this connection, I am somewhat concerned about the rapid pace of change and the strong competitive pressures that have emerged, which have contributed to uncertainty on the part of both market participants and supervisors about the nature of the ongoing process. The available information is limited and is not easily interpreted, while many of the longer-run implications, which might require responses from supervisory authorities, are not yet clear. Particular areas of concern include instances in which the new market instruments might not be appropriately priced and institutions might have increased difficulty in assessing and managing exposure. The work of the Cross Committee has been very useful in providing a survey of the new innovative instruments and in pointing out some of the potential risks, and I would support continuing efforts by the authorities in the major financial centers to improve their understanding and to strengthen the data base.

The staff paper stresses the integration of the activities of commercial banks and other financial institutions that has occurred, as well as the increased integration of financial markets across countries. Therefore, I support the coordination of financial institutions' supervision among countries. It is evident that increased capital mobility on a global scale and its impact on the conduct of macroeconomic policy have increased the interdependence of all economies; this underlines once more the need for members to explicitly take into account the international aspects of their domestic policy choices.

Mr. Salehkhou made the following statement:

The staff papers provide a thorough and frank assessment of the present and prospective situation in the international capital markets. The picture that emerges is not very encouraging for the world economy in general and for the developing countries in particular. According to the staff's figures, international bank lending to these countries has shrunk from $85 billion in 1980-81 to $9 billion in 1985 and has turned negative by $4 billion in the first quarter of 1986. This disquieting trend does not augur well for the world economy. It demonstrates that the problems facing developing countries, including the debt problem, are worsening, despite the commendable and painful adjustment efforts.

At a time when these countries' exports are encountering growing protectionist pressures in the markets of industrial countries and when prices of oil commodities are at historically low levels, a reduction of such magnitude in bank lending cannot have but the most dampening effects on imports and hence on any prospects for growth. According to the latest issue of <u>IFS</u>, the Fund's overall index of nonfuel commodity prices in U.S. dollars fell to its lowest level in more than ten years. Moreover, average commodity prices in July 1986 were 11 percent below January 1986 prices.

The latest figures on international lending and deposit taking show the effects of the recent decline by half of oil prices, which will probably add a number of oil countries to the list of countries for which the banks are reluctant to increase their exposure.

Given the linkages in the world economy, and especially the fact that 25 percent of the external trade of industrial countries is with developing countries, I wonder whether industrial countries realize that in the final analysis this situation will backfire on their economies. In fact, I am convinced that the sluggishness of these economies is due greatly to the fact that developing countries are forced to reduce drastically their imports because of a lack of foreign exchange and because of the heavy weight of debt servicing in their external accounts.

Even more discouraging is the fact that the reduction of lending to developing countries by banks is geographically broad based and, except for a handful of countries in Asia, net reductions in exposure occurred everywhere else in the world. Is this loss of financial flows compensated for by flows from other sources? That does not appear to be the case.

As everyone knows, the growth of official development assistance is at best stagnant, especially after the sharp decline in oil prices, which reduced the potential for assistance by OPEC countries while industrial countries have deliberately limited such assistance in recent years. The assistance from multilateral institutions is also constrained by policies that are favored by industrial countries. For example, the Fund, in implementing such policies, is now receiving net repurchases from borrowing members even though the needs of those members are far from having decreased. Furthermore, even a modest allocation of SDRs--a way in which to alleviate the problems facing developing countries--is strongly resisted by major industrial countries. However, the World Bank, which could play a major role in promoting growth and which has the actual as well as the potential means to mobilize the necessary resources, is prevented from increasing in real terms its lending and will in fact become a negative net provider of resources in the near term.

Is this the policy that is to help solve the debt problem? By no means. Should the trend continue, I am afraid that this situation, compounded by rising protectionist pressures, could lead to a worldwide recession. Therefore, what is needed is a whole new attitude and a corresponding vision together with the will to address these fundamental problems. Developing countries have been doing their part by maintaining imposed adjustment policies. For these to succeed, industrial countries should revise their dogmatic views and not wait for special cases to arise to react.

If commercial banks are allowed to continue along the same path, governments, directly or through multilateral institutions--namely, the Fund and the World Bank--should step up their assistance. As for the Fund, this would call for an early agreement on a sizable allocation of SDRs, the return to an adequate policy on access, and the starting of discussions on the Ninth General Review of Quotas.

Failing this urgent reversal of policies, the prospects would be bleak indeed. Commercial banks will continue to adopt, as the staff paper indicates, a "wait-and-see" attitude, providing such excuses as the cohesion of the banks, the contribution by governments, guarantees by multilateral institutions, and the prerequisite of cofinancing. We will then continue to hear of new concepts. After concerted and spontaneous lending, we are now discovering so-called "semispontaneous" lending. What else is in the offing? The fact is that the banks are dictating their will not only to developing countries but also to the supervisory authorities in industrial countries.

I welcome the inclusion in the staff papers of sections on foreign investment and capital flight. However, I wish to see more work done by the staff on these issues of special interest to developing countries with particular emphasis on the efficiency of direct investment.

In the area of foreign investment I find it ironic that one of the obstacles to investment in developing countries are the existing and potential trade barriers in industrial countries--the same countries that are advising developing countries to open up to foreign investment and to promote exports. Moreover, the staff states that "even with a recovery in the economies of developing countries, direct investment flows were not expected in the near term to increase sufficiently to offset the decline in bank lending."

I believe that such new features as the conversion of debt into equity will necessarily be limited, since private investors would only seek profitable institutions and the nature and scope of public enterprises make it difficult to satisfy this precondition in all circumstances. Moreover, it is politically and socially difficult for a government to sell only profitable enterprises and to keep those facing financial problems.

I strongly support the statement on page 21 of SM/86/193 that management and staff have made it clear to banks that the

Fund's Executive Board would not be bound by conditions that are specified in loan agreements involving procedures that have not been agreed for a specific member by the Fund's Executive Board.

Mr. Zecchini made the following statement:

The staff has provided a detailed and thorough analysis as a basis for our review of the recent and prospective role of international capital markets in the international monetary system. I believe that at present an appropriate role is played by the markets if the financial flows in these markets are conducive to a viable pattern of resource allocation--in other words, a pattern that can support economic development while easing the tensions caused by the international debt problem.

If the present review is framed in this context, it must be acknowledged that in the present period we are facing some disquieting developments and prospects together with few positive developments. It is disquieting to see that the trend toward a reduction in lending to developing countries continued in 1985 as well as in the first quarter of 1986. Such a trend is particularly evident in bank lending; the decline in bank lending might be imputable mainly to the supply side of funds, as interest rates and spreads have been falling continuously over the previous two years. In this connection, the staff could elaborate more on the evolution of spreads and other cost conditions, their relevance in the granting of credit and in pricing risk, and the signals that can be derived from these cost elements about credit rationing to the developing countries. A section on these aspects in the main staff paper would be appreciated in the next review.

It is disquieting that the situation of split markets, which once characterized the debtor side of the market, now extends also to the creditor side. Lack of cohesion on the creditor front appears to be very destabilizing for the international monetary system, since it tends to curtail the channeling of resources to the countries that have the greatest need and leads to a concentration of credit risk.

It is also disquieting to see that in 1985 as well as in the first quarter of 1986 there have not been the conditions in which an expansion of disbursements by the World Bank to the group of developing countries could take place. I understand that delays in implementing investment projects and the financial straits of debtor countries have contributed to this development. However, more effective operating procedures in credit granting and disbursement could have lessened the extent of the decline.

On the positive side, continuous progress in financial innovation is increasing the actual and potential supply of credit as it allows a better reconciliation of the preferences of creditors with the needs of debtors. In particular, the expansion of securitization, conversion of debt into equity, and debt swaps opens new promising avenues to meeting the financing requirement of debtor developing countries.

Given the previously mentioned developments, the focus of the present review should be mainly on the attitude of market participants and official authorities that is most appropriate to restore a balanced pattern of financing and adjustment for debtor developing countries and to channel more resources for the most successful development strategies. I will concentrate on these aspects by pointing out some crucial elements of a viable approach without repeating the many other useful considerations that were presented in the staff papers and in the discussion of last year, which I broadly endorse.

On the debtor side, we are confronted with a much more differentiated picture than in previous years. Three groups in particular can be distinguished: developing countries that are at an advanced stage in their adjustment efforts and can enjoy more flexibility in tapping various financing sources; developing countries whose difficulties have been aggravated by the sharp turnaround in their terms of trade but are not ready to sacrifice their economic growth to step up their adjustment efforts; and countries that are still delaying adjustment or where the degree of adjustment is inadequate.

Despite these differences, it is important for all three groups to stress the importance of structural improvements in domestic economic environment more than short-term demand management measures. Only measures that have the long-term impact of the expansion of the production base, of economic initiative, or of domestic savings can avoid the repetition of the short-lived adjustment cycles that have characterized the economic development experience of the previous ten years. For example, a crucial feature of the so-called growth-oriented adjustment strategy should be a carefully planned and tightly monitored scheme to promote optimal use of resources and to fully mobilize domestic as well as foreign savings.

Recent statistical evidence indicates that more effective incentives are required to stem capital flight and to promote foreign direct investment. In this connection, my authorities are looking forward to a rapid activation of the MIGA. Moreover, a more liberal attitude toward international trade on the part of both industrial and developing countries seems to be a necessary condition to enable debtor countries to achieve a sustainable balance of payments position.

On the commercial bank side, there has been an increasing shift away from balance of payments lending and toward trade and project-related loans. This latter type of credit development cannot be considered negatively to the extent that it favors a more appropriate utilization of financial resources while indirectly induces the borrower to accept a more extensive kind of conditionality that in the past for general purpose loans. However, if this attitude would usher in a withdrawal of the banking system from general purpose lending, the Fund and the authorities of the major countries should resist such a development through various means. Moral suasion and disincentives are the best means to achieve this end, while more caution should be used in providing incentives. In this respect, the tendency of commercial banks to shift the burden of financing developing countries to the authorities of creditor countries by calling for more officially supported credit or official export guarantees cannot be fostered, since it involves unwarranted risk transformation for their assets. Any provision of official financial support to these countries should not constitute an incentive to reinforce that tendency. Limited forms of incentives could be more appropriate, like those in the area of the fiscal treatment of reserves against credit risks and in the area of the categorization of external loans for bank supervision purposes.

A substantial participation by banks in concerted loans should also be supported. This does not imply that the role of the Fund should be gradually reduced to its catalytic role or should be constrained to lending to nonmarket borrowers. On the contrary, the use of Fund resources should continue to be significant, especially for countries with large financing gaps and at an early stage of adjustment, provided that their efforts to address their imbalances are substantial.

In the area of enhanced surveillance, some caution is called for in spending the Fund's credibility. At this stage, an appraisal of the impact of the enhanced surveillance procedure is not possible, as the procedure has not become fully operational. Nevertheless, I believe that this procedure might play an important catalytic role only in selected cases in which the record of adjustment of the country involved offers enough guarantees that the country's policies will be adequate. Furthermore, the Fund's assessment should not play an ancillary function with respect to the specifics of the arrangement between the banks and the country concerned.

Another aspect of surveillance that has to do especially with industrial countries, namely, the liberalization of financial markets has greatly enhanced the international transmission of monetary and fiscal impulses. In such a context, the surveillance function of the Fund has acquired a new dimension in the sense that it is being held responsible for the promotion of a better coordination of economic policies in major countries. I strongly endorse these new responsibilities of the Fund as well as all practical arrangements that can allow the Fund to exert a larger influence on the policies of major countries.

As to the role of the World Bank, it is evident that structural and sectoral adjustment loans have been and will continue to be in the near future the fastest growing component of its credit. On the one hand, such a development might generate some perplexity about the extent to which this type of credit duplicates the functions of Fund credit and might involve a different degree of conditionality with the result of a possible "conditionality arbitrage" as countries might shift their credit demand from one institution to the other according to their conditionality preferences. On the other hand, it must be recognized that it is necessary to channel more market resources to nonmarket borrowers, and this can also be accomplished through the intermediation of the World Bank. Moreover, such support is a very useful supplement to the official resources provided by the Fund, especially at a time when a consensus on new SDR allocations and quota increases has not yet been reached. However, in accepting this development, it is necessary to avoid having the World Bank's involvement, which calls for sectoral or structural measures, unduly delay a more broadly based adjustment approach as advocated by the Fund. To this end, it is crucial that the conditionality approach of the World Bank be made consistent or be coordinated with that of the Fund, and that whenever possible the intervention of the World Bank through nonproject loans should be linked to Fund lending or to its economic policy surveillance role.

I wish to make a few comments on the role of national governments in international lending. There have recently been several calls for a more supportive intervention of official entities in two areas--export credit and bank supervision. In both areas, improvements might be achieved in the direction of making official decisions related to credit more responsive to the internationally based assessment of the adequacy of the economic policies of the borrowing countries. However, it cannot be expected that the official intervention by itself can solve the problem of an inadequate supply of financial resources by market sources. In fact, flows of export credit and guarantees are conditional upon the specific commodity and geographical composition of borrowing countries' imports and bilateral trade relationships. Therefore, their expansion cannot go beyond these limitations.

Furthermore, bank supervision cannot become more lenient or even complacent for the purpose of either rescuing countries from dire straights or easing the debt problem. The maximum support that can be expected is making the credit risk assessment more rational, as it will be based on more comprehensive information about the economic conditions and prospects of the borrower.

Boyond this, it is the responsibility of financial policymakers in both the creditor and debtor countries to create the overall conditions for a normalization of the debt situation.

Mr. Rye made the following statement:

It would be impracticable to deal with the full range of issues covered in the staff's papers, and I will be selective in my comments.

The developments and prospects in the area of debtor/creditor relations described in the staff papers are mixed. It is certainly discouraging that cohesiveness within the banking community is diminishing at a time when the financing requirements of some countries without normal access to credit markets are likely to increase substantially. I would emphasize that only some such countries are involved, because the latest world economic outlook paper shows that outside the fuel exporting group of developing countries current account deficits are expected to be reduced slightly in 1986. Accordingly, the increase in financing requirements will not be across the board.

It is encouraging that financing modalities are evolving in the direction of restoring normal debtor/creditor relations for some countries--for example, sales or swaps at a discount of claims on developing countries, and debt equity conversions. These are very positive developments that should be fostered. While I have noted the cautionary observations of the staff about the potential complications that such arrangements might cause for subsequent concerted lending packages for these countries, should they be necessary, I think that it would be unfortunate if concerns on this score were to inhibit the further development and wider application of such techniques.

With cohesion within the banking community apparently already on the wane, failure to make progress would imply not maintenance of the status quo, but the likelihood of forced and less orderly changes taking place, as the result of unilateral withdrawals by some banks. We should therefore strongly urge the banking community to approach the question of burden sharing among banks in a more positive and flexible spirit.

A subsidiary point concerns the staff comment that "in some areas, official coordination will be required to secure an adequate volume of bank flows." If this comment means that the Fund and the World Bank will need to play a continuing active role in bringing together bank financing packages, I agree. But if the implication is that national authorities should bring direct influence to bear on their national banks, I would enter a reservation: the extent to which national banks should involve themselves in the lending decisions of their banks at the individual customer level is a matter for them to decide. In the case of some of my own authorities, the answer is not at all.

Like Mr. Ismael and some others, I was somewhat surprised by the relative lack of reference to the Baker initiative in the staff papers. I would have liked to see some discussion of such questions as whether the indicative financing amounts in the plan outlined by Secretary Baker in Seoul are still seen to be of the right order of magnitude in view of the subsequent changes in the economic environment, including lower oil and other commodity prices. Some indication of the present status of the list of 15 countries on which the plan was centered would also be helpful.

The staff papers also did not contain much reference to one of the key conditions necessary for the debt strategy to be successful, namely, that heavily indebted countries have fair access to world markets for their exports. According to the World Development Report, 1986, in 1980-82 domestic prices of selected agricultural commodities in industrial countries averaged 43 percent above border prices. Since then, major industrial countries have intensified market restrictions and subsidies producing what must be called a crisis for developing and other efficient agricultural export countries. For many countries that rely on commodity exports, this crisis compounds the very serious problems of depressed prices and weak demand in commodity markets generally. Many commodity prices are at record lows in real terms, and the outlook is bleak. There ought to be serious concern about the implications of this crisis for the integrity of the multilateral trading system, the solution to international debt problems, the stability of the international financial system, and the attainment of economic and political stability in developing countries. Much lip service is paid to the close link between debt, trade, and growth for heavily indebted countries, but in practice that link is too often not allowed to function properly. The Baker formula of "structural adjustment with growth" is admirable, but there will be no growth unless a favorable external environment is also created.

One development in capital markets that is a cause for concern is that private lenders are apparently becoming more dependent on the multilateral institutions and other "official" support. In this connection, I have noted the presumption by banks, when specifying the terms for multiyear rescheduling arrangements, that the Fund will provide ongoing monitoring arrangements, and the statement in the staff paper on export credit developments that "banks are limiting their exposure to developing countries by seeking and receiving official guarantees for an increasing share of their trade-related lending to those countries...." It seems that such developments are taking us away from not closer to, a restoration of normal debtor/creditor relationships for countries that have made progress in their adjustment efforts.

The staff papers pay special attention to the issue of capital flight. The necessarily rough estimates presented by the staff suggest that capital flight has been an important factor in the financing difficulties of a number of heavily indebted countries. The staff also suggests that exchange and interest rates, and the strength--and thus the credibility--of a country's adjustment efforts are key factors in arresting and reversing capital flight. An additional point, perhaps, is that less gradualist adjustment efforts are likely to be more conducive to a return of flight capital not only because countries making them are not so prone to "adjustment fatigue" but also because gradual adjustments in exchange rates, interest rates, and prices are likely to spawn expectations of further adjustments, making the holding of savings abroad for a period perhaps even more attractive.

On developments in industrial countries, I agree that deregulation of financial markets and the innovations that have resulted have improved efficiency in, and the resource and risk allocation functions of, these markets. They are therefore welcome developments. However, they also present some challenges.

There is evidently a trend whereby the effects of monetary policy on the real sector are now felt more through exchange rates and thus by the tradables sector than through interest rates and credit rationing, which tend to have more influence on domestic expenditure. Such a development presents difficulties--for example, in the United States it might intensify protectionist pressures. But it should not be altogether unwelcome. In some countries, it highlights the inflexibilities in the nontradables and sheltered sectors, and is increasing the pressure for faster reform in these areas.

Financial deregulation has undoubtedly made the task of financial supervisors more difficult. Nevertheless, I believe that supervisory authorities are responding adequately to the challenges, and I would endorse the general approach that places more emphasis on "supervision" than "regulation," and which extends its scope beyond the balance sheets of banking institutions. As to any extension of the central bank safety net, I agree with the staff that this must not be at the expense of maintaining market discipline. In that connection, authorities must of course maintain stable financial policies, but they can also limit risks by ensuring and making it clear that the safety net is not a substitute for the proper exercise of their responsibilities by the managements and shareholders of financial institutions, and that if resort to its use is required in order to avoid possible contagion, the institution itself will not necessarily be protected but could be required to exit from the industry through, say, a merger or takeover.

I fully support the proposal to issue an Occasional Paper based on the staff papers.

Mr. Hospedales made the following statement:

Earlier this year the Executive Board conducted an extensive review of the debt situation and the current initiatives for solving the debt problem. I support the publication of the staff papers that have been provided for the present review.

The re-establishment of generalized creditworthiness is a sine qua non of growth-oriented adjustment. However, there seems to be little reason, on the basis of the staff's analysis, to remain complacent about the outlook for both capital flows to developing countries, especially heavily indebted members, and the early resumption of durable growth in these countries.

The first interesting point that attracted my attention is the continuing slowdown in net lending to developing countries, which underlies the inability of these countries to take advantage of new opportunities for borrowing that stem from increasingly innovative techniques in and the liberalization of financial markets. Substantial adjustment and structural changes by developing countries, particularly the most heavily indebted ones, have not resulted in a return to voluntary lending in adequate amounts, and net resource transfers from these countries have remained a cause for concern. Nevertheless, it is equally clear that in addition to the restrictive loan/supply conditions, the amount of borrowing is also demand determined, in the sense that the amount is a reflection of increasing concern by debtor countries about structuring a debt profile that is consistent with growth and export capacity. In fact, the deterioration shown by conventional indicators is a cause for major concern among debtor countries themselves, and is influencing their attitude toward international borrowing. The combined current account deficit as a proportion of exports of goods and services of developing countries as a group is expected to increase in 1986. The external debt and debt servicing of capital-importing developing countries as a group relative to both exports and GDP are deteriorating. Projections of the growth of developing countries as a group are now being revised downward, as are the growth projections for countries with recent debt servicing problems as a group. Export earnings of capital-importing countries as a group have declined in the context of a substantial deterioration in their terms of trade, and growth in major industrial countries has weakened.

It is clear that since 1982 sustained growth in debtor countries and improved debt profiles have not been achieved by many capital importing developing countries, despite their courageous adjustment actions. It seems to me that to gain a long-term solution to the debt problem output growth in the world economy--both industrial and developing country groups--must be raised much beyond what is currently projected. It is only through a process of sustained world economic recovery that the resumption of normal debtor/creditor relations can take place. The prices of primary commodities must be stabilized, and their long-term secular decline must be reversed. Exports must be promoted, and investment levels, which are below historic averages, must be raised. International coordination of economic policy should continue to receive heightened attention and protectionism must be resisted forcefully. A liberal import policy as well as the elimination of subsidies to exports by major market economies in particular are key elements. The decline in real interest rates by macroeconomic and microeconomic actions must be given further momentum.

The major challenge facing the international community is to proceed as expeditiously as possible to implement a strengthened debt strategy, the main elements of which I have outlined. There is no doubt that under this process supply conditions for international capital should be improved. Significant debt relief should continue to be provided through reduced interest rates, new money from banks, and multiyear rescheduling arrangements. The modalities of new money provided by banks should be carefully evaluated--for example, commitments to provide new trade financing, relending or on-lending to the private sector, and conversion of existing debt into equity. In the latter area, improvements in the terms and conditions of multiyear rescheduling arrangements could bring increasing, although modest, benefits, especially with respect to the extension of maturities, the lengthening of grace and consolidation periods, and the lowering of spreads. In this connection, additional lending to problem countries, despite the absence of any long-term commercial interest, should be given due consideration by banks without of course bank regulators abandoning prudential considerations. In addition, official credit insurance agencies, which have only gradually become more flexible in their policies, could play a more important role as an additional source of financing.

An important source of finance on the supply side continues to be enhanced intermediation by the mutilateral financial institutions. The development banks have an important role to play in the provision of long-term financing--a role that has been enhanced over the previous year, when there was an increase of 22 percent in new lending commitments. However, the capacity for long-term financing by development banks in increasingly adequate amounts in support of sound projects and needed structural reforms and to catalyze commercial financing is narrowly circumscribed by the present capital structures of the banks. Therefore, substantial capital increases are justified in the current circumstances.

At the shorter end of the market I am deeply concerned about the net reduction in Fund credit, which is now projected to be negative over the next two years, although the proposed stand-by arrangement for Mexico could change the situation somewhat. This reduced activity by the Fund comes at a time when the capital requirements of developing countries, including the most heavily indebted members, are substantial in the context of the requirements of a growth-oriented debt strategy. I regret the reversal of the policies to provide substantially larger resources for substantially longer periods, a key factor in overcoming the debt crisis. Therefore, it seems that greater use should be made of the extended Fund facility, and that access under the enlarged access policy should be increased. Furthermore, there is an urgent need to adapt conditionality to the requirements of the growth-oriented strategy. The steady increase in conditionality under the compensatory financing facility is regrettable, since it deprives the international community of a quick-disbursing form of emergency finance.

Due note should be taken of several other important aspects of the problem of easing the debt crisis and facilitating the resumption of growth by debtor countries. First, the question of interest rate relief beyond the reduction of spreads merits serious attention. Present real interest rates are still above traditional levels. Second, there is the question of the increasing number of countries with overdue financial obligations. The modalities for dealing with that problem should be re-evaluated in the light of the worsening of the situation. Third, there is no reason why multiyear rescheduling arrangements should be limited to countries with formal enhanced surveillance arrangements with the Fund if their economic and especially their balance of payments performance is adequate. Nor is there a need for the Paris Club to have a link between its rescheduling and Fund financial arrangements or even enhanced surveillance arrangements. There is also no need for the Paris Club's hesitant approach to multiyear rescheduling arrangements. Fourth, the reform of the international monetary system is an essential ingredient of the solution to the debt problem, particularly as the solution to the debt problem requires improved coordination of major countries' policies.

Mr. Sengupta made the following statement:

The staff papers clearly indicate that in 1985, as in 1984, the increase in net lending through banks and bond markets was due mainly to borrowing by industrial countries; new lending to developing countries further declined. Bank lending to industrial countries rose in 1985 by $86 billion while such lending to developing countries increased by just $9 billion--a rate of increase of just 2 percent--even less than the growth of $16 billion in 1984. As to the 15 heavily indebted developing countries, on whose problems the international community appropriately has tried to concentrate, net lending increased by just $1 billion in 1985, compared with $5 billion in 1984. In the case of capital importing developing countries, the banks have taken $9 billion in 1984 and $5 billion in 1985 more as deposits than they lent to those developing countries. This result has occurred despite the severe adjustment efforts by developing countries and after some concerted lending packages were arranged.

Table A33 in the statistical appendix of the world economic outlook paper indicates that the payments imbalances of developing countries as a whole further contracted from $32.3 billion in 1984 to $18.8 billion in 1985--an indication of the magnitude of the adjustment. The corresponding figures for the 15 heavily indebted countries are a deficit of $1.1 billion in 1984 compared with a surplus of $0.4 billion in 1985, which indicates a clear reversal of the flow of resources. This situation shows, first, that the developing countries have been doing their best to adjust, and, second, that despite these efforts and the international incentives to reverse this trend, including concerted lending packages, banks have continued to be reluctant to lend to developing countries in a major way. At the same time, the banks' reluctance to lend appears to be having some highly undesirable manifestations, one of which seems to be to make their lending conditional on lending by other creditors and in some cases by export credit agencies for the World Bank. As the staff rightly notes, such a conditional approach means that there will be problems arranging new money packages.

These developments show that the adoption of appropriate policies by debtor countries is not a sufficient condition for reviving financial flows to these countries. Therefore, it is necessary for the international community to create conditions that would make the resumption of lending by banks possible. The Baker initiative has to be followed up by official actions by the authorities in industrial countries to support the actions of commercial banks. It is not clear whether these governments have come forward with a clear-cut policy on this matter in order to reduce the fears of bankers. If it is agreed that markets should not be tampered with, then the alternative must be a substantial increase in the resources of multilateral institutions for this purpose together with substantial increases in bilateral aid. There should also be an increase in the Fund's resources through an early agreement on the Ninth General Review of Quotas, and the access limits should be increased. To ensure that Fund resources do not add to the debt burden of countries, the terms, namely, the rate of charge, should be reasonable, and the period of repayment should be extended.

Unfortunately, the staff papers have not dealt with the debt problems facing low-income countries in any great detail. Several of those countries, including members in sub-Saharan Africa, have experienced serious payments problems that resulted in the accumulation of arrears, including overdue financial obligations to the Fund. The problems facing the low-income countries, like the problems facing the larger developing countries, are of systemic importance, as the number of low-income countries facing such problems is large, their capacity to adjust depends crucially upon additional financing, many of those countries have reached the social limits of tolerance of adjustment, and an increasing number of those countries are falling into arrears even to the multilateral institutions such as the Fund. A number of low-income countries that do not face debt problems at present have the potential to face such problems if their needs are not fully recognized and met in time. This latter group of countries is not being provided with adequate concessional flows from multilateral institutions and other sources on the grounds that they are creditworthy and could therefore borrow from commercial banks. However, commercial bank borrowing is increasing their debt burden and reducing their creditworthiness. In these cases, there is a need for multilateral institutions like the Fund and other international donors to act not only to introduce rescue measures in the event of a crisis, but also to take preventive steps to ensure that additional countries do not incur debt beyond their repayment capacity. I asked the staff for a study of this matter, and I wonder whether there are any plans to undertake it. The study of such contingency planning should be given the highest priority by the staff. The staff has observed that official development assistance has ranged from $33 billion to $35 billion in 1980-85. This level, according to the OECD, is likely to be maintained by most DAC members in the coming two or three years. Therefore, it might not be easier to maintain adequate financial assistance even from bilateral sources.

It is not clear how far foreign direct investment can be a substitute for other forms of foreign capital inflows. Countries with small internal markets, few natural resources, a relatively underdeveloped infrastructure, and limited possibilities for manufactured exports might not be able to attract substantial direct investment, even with liberal regulation and generous incentives. Foreign direct investment might of course be useful as a tool for transferring technology, but one is not sure of the extent to which it can be an instrument for transferring resources in any substantial way. I agree with the staff that in the near term these flows are not expected to increase so dramatically as to offset the decrease in bank lending.

The staff's comments on capital flight are interesting, as is Mr. Ortiz's suggestion that commercial banks themselves have encouraged financial flight. While I agree with the staff that sufficient data are not available to make any precise judgment on the issue, it might be useful to undertake further work in the area and to examine whether some international measures to control capital flows could be developed that would not prevent capital movements among industrial countries or from the industrial to the developing countries but could instead arrest or reverse the flow from the developing countries to industrial countries.

The role of the Fund in assisting developing countries to design growth-oriented adjustment programs is seen by banks as central to securing external capital flows. In a considerable number of cases, the Fund's direct financial support is of substantial importance. The Fund's direct financial assistance has been falling in recent years. For example, loan commitments by the Fund to the developing countries declined from SDR 11.3 billion in 1983 to SDR 3.3 billion in 1985. The declining trend has continued thus far in 1986.

There is a need for contingency planning and to take preventive action rather than to engage in improvisation to meet crisis situations. Mr. Ortiz referred to the 1930s experience of debt defaults; present conditions, as he clearly noted, are leading many of the debtor countries inexorably to a possible repetition of the 1930s experience. The situation of many low-income countries is worse, and some debtor countries could face a critical situation in the very near future if appropriate actions are not taken. The crux of the problem is that very little additional finance is flowing to these countries. The staff has indicated that there is very little prospect of an improvement in this situation. Whether one likes it or not, the Fund will have to play a major role in such situations, either as a provider of additional finance or as a catalyst of additional finance as well as in promoting adjustment in countries, including members other than the debtor countries; there must be adjustment in the industrial countries and in the international monetary system. These different roles are mutually interconnected and all are important. It has been demonstrated time and again that it is not possible to have adjustment without financing. Those who do not favor financing for countries that are not following proper adjustment policies should accept the responsibility for providing all the financing that is necessary for countries that faithfully adopted adjustment policies but still do not have sufficient financing. It would be highly irresponsible to react to such situations by asking for more adjustment.

We should carefully consider why it is that the Fund, which is supposed to be making recommendations that are in the interest of the receiving countries, is so unpopular in those countries. We must try to understand this reality and not dismiss the situation by saying that the governments of the developing countries are irresponsible, or are ignorant of their own interests, or are unwilling to adopt difficult measures. Most of these countries have made great sacrifices not only in their struggle for independence but also during the period of postliberalization reconstruction. For example, a conclusion that Viet Nam is defaulting because it is unwilling to adopt difficult measures that would cause hardship for its people would not be believed by any countries in our part of the world. Many Latin American and African countries have adopted very harsh policies in the recent past. What Argentina, Brazil, and Mexico have done in recent years is without precedent. It is also untrue that all the policies recommended by the Fund are unacceptable. The main problem is that there is no assurance that if these policies are followed and hardship is accepted, financing will be forthcoming and growth will be restored in the near future.

The Fund should undertake an exercise in contingency planning--by examining the role that it could play in avoiding crises--and in reintroducing growth. The Fund should examine how much finance it must provide if it is to succeed as a catalytic agency in mobilizing finance and if it fails to attract suitable funds but has to provide the financial support to countries that are implementing Fund-supported programs. This examination should involve the middle-income highly indebted countries as well as the low-income highly indebted countries, including countries in Africa and in other regions that have potential debt problems. We should be prepared to consider alternative scenarios and should make recommendations to the Interim Committee.

The Executive Directors agreed to continue their discussion in the afternoon.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/86/142 (8/29/86) and EBM/86/143 (9/3/86).

2. PEOPLE'S REPUBLIC OF THE CONGO - STAND-BY ARRANGEMENT - EFFECTIVE DATE

1. The Fund notes the arrangements described in EBS/86/138, Supplement 4, with respect to the financing of the People's Republic of the Congo's estimated balance of payments deficit in 1986 and that the arrangements are satisfactory.

2. Accordingly, the stand-by arrangement for the People's Republic of the Congo (EBS/86/138, Sup. 2) as amended by paragraph 3 below, shall enter into effect on August 29, 1986.

3. Paragraph 2(a) of the stand-by arrangement for the People's Republic of the Congo (EBS/86/138, Sup. 2) is amended by changing "November 14, 1986" to "December 1, 1986."

Decision No. 8379-(86/143), adopted
August 29, 1986

3. RULES FOR 1986 REGULAR ELECTION OF EXECUTIVE DIRECTORS - GOVERNORS' VOTE

The Executive Board approves the report of the Secretary (EBD/86/199, Sup. 1, 8/29/86) on the canvass of votes of the Governors on Resolution No. 41-4, with respect to the Regulations for the Conduct of the 1986 Regular Election of Executive Directors, approved by the Executive Board (EBM/86/121, 7/25/86) for submission to the Board of Governors. The Governors' vote on the Resolution is recorded as follows:

Total affirmative votes		903,136
Total negative votes		0
Total votes cast		903,136
Abstentions recorded	0	
Other replies	0	
Total replies		903,136
Votes of members that did not reply		34,489
Total votes of members		937,625

Decision No. 8380-(86/143), adopted
August 29, 1986

4. SUPPLEMENTARY FINANCING FACILITY SUBSIDY ACCOUNT - DETERMINATION OF AMOUNT OF SUBSIDY PAYMENTS

The Executive Board approves the approach recommended in SM/86/214 (8/22/86) for determining the amount and timing of subsidy payments to eligible members from the Supplementary Financing Facility Subsidy Account.

Decision No. 8381-(86/143), adopted
August 29, 1986

5. BAHRAIN - TECHNICAL ASSISTANCE

In response to a request from the Bahrain Monetary Agency for technical assistance in the field of bank supervision, the Executive Board approves the proposal set forth in EBD/86/236 (8/27/86).

Adopted September 2, 1986

6. APPROVAL OF MINUTES

The minutes of Executive Board Meeting 86/7 are approved. (EBD/86/235, 8/26/86)

Adopted September 2, 1986

7. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/86/209 (8/28/86) and by an Assistant to Executive Director as set forth in EBAP/86/211 (8/29/86) is approved.

APPROVED: May 11, 1987

LEO VAN HOUTVEN
Secretary