May 20, 1987

To: Members of the Executive Board

From: The Secretary

Subject: Final Minutes of Executive Board Meeting 86/144

The following correction has been made in the final minutes of EBM/86/144 (9/3/86):

Page 3, item 1, para. 1, penultimate line: for "(SM/86/84, 8/7/86)," read "(SM/86/194, 8/7/86),"

A corrected page is attached.

Att: (1)

Other Distribution:
Department Heads

1. INTERNATIONAL CAPITAL MARKETS - DEVELOPMENTS AND PROSPECTS, 1986

The Executive Directors continued from the previous meeting (EBM/86/143, 9/3/86) their consideration of a staff paper on recent 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/86/194, 8/7/86), and Export Credit Developments, 1984-85 (SM/86/223, 8/26/86).

Mr. Yang made the following statement:

While there was a rapid increase in total net lending through international bank credit and bond markets in 1985 and the first half of 1986, spontaneous lending has remained a negligible proportion of the capital importing developing countries' financing. In fact, under the current unfavorable external conditions, which are characterized by a marked slowdown in the world economy, a steep decline in the prices of most primary commodities, and a continued deterioration in the terms of trade of the developing countries, the debt situation in many countries has worsened. Although the realization that a viable long-term solution to the debt problem must be based on a strategy that is designed to promote economic growth in debtor countries is gaining ground, the requisite financing for economic growth in those countries is still not available, a trend that is most disturbing at a time when the financing needs of those countries are both vital and urgent. Nearly one year has passed since Secretary Baker announced his debt initiative in Seoul, but the banking community, as the staff notes, still has a "wait-and-see" attitude toward the implementation of the Baker proposal. Despite the enormous adjustment efforts by many debtor countries, there is apparently a continuing reluctance among the banks to increase their exposure to developing countries. Multilateral development banks have played an important role in the past in providing long-term finance in support of sound projects and needed structural reforms and in catalyzing commercial financing, but the adequacy of the resources of those institutions--especially the World Bank--to perform such important tasks is still open to question. In sum, recent developments in the international capital markets suggest that further efforts to deal with the debt problem are urgently required.

A well-designed debt strategy must include, as an essential element, the responsibility of the industrial countries to maintain policies that are conducive to growth and stability. A sustained rate of growth in output and trade, reductions in interest rates, a stable pattern of exchange rates, and a rollback of

protectionism in the industrial countries should be considered indispensable to the solution to the debt problem. In this context, strengthening a policy coordination among the major industrial countries to correct their financial imbalances is one of the most pressing tasks.

The Fund's direct financial support will be of vital importance in solving the debt problem. Accordingly, the access policy and the Ninth General Review of Quotas should enhance the effectiveness of that crucial function of the Fund.

It is understandable that commercial banks have sought to associate new financing and restructuring with the progress of debtor countries in implementing adjustment programs. However, there is a considerable lag between the implementation of appropriate adjustment policies in debtor countries and the readiness of creditors to undertake spontaneous lending in support of these policies. I am inclined to believe that some effort should be made to shorten the lag. In this connection, the Fund might have a role to play in evaluating the achievements of the adjustment programs of the debtor countries in a timely manner in order to promptly catalyze the needed financing. Meanwhile, a rigid link between the Fund's assessment and bank lending should be avoided.

It is undeniable that the international debt problem is due partly to poor risk management by the commercial banks. It is in the best interest of the banks to participate in solving the debt problem. The financial stability of creditor countries will be at stake if the debt problem cannot be appropriately solved. No time should be lost in implementing the growth-oriented debt strategy that will not only give the economies of debtor countries a chance to grow but also improve the quality of outstanding debt, so that the financial health of the creditors will be enhanced.

I agree with Mr. Ismael that an explicit assessment of the progress in implementing the Baker initiative in the staff paper would have been helpful.

Mr. Archibong made the following statement:

It is interesting to note from the staff papers the continued improvement in the structure of capital markets since the previous discussion on this subject in November 1985. The structural changes that have occurred include, among others, further integration of banking activity in individual financial centers, the growth of interbank activity, expansion of the international bond markets--which is attributable partly to the substantial decline in long-term interest rates--the growth in