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The Chairman's Summing Up at the Conclusion
of the Discussion on International Capital
Markets - Developments and Prospects, 1986
Executive Board Meeting 86/144 - September 3, 1986

I will first summarize the views expressed by Executive Directors on the general changes that are taking place in international capital markets and then turn to developments in the debt situation.

1. Changes in financial markets

Directors noted the general buoyancy of capital market activity in industrial countries in 1985-86. They associated these conditions in part with the wave of liberalization and innovation that has been occurring in many financial centers. On balance, most Directors thought that these changes have the potential to increase the efficiency of international capital markets. However, a number of Directors expressed concern that developing countries had enjoyed little access to the dynamic sectors of the capital markets.

Many Directors noted that the G-10 report entitled Recent Innovations in International Banking, prepared by a study group under the chairmanship of Mr. S. Y. Cross, provided a very helpful analysis of the changes taking place in the markets. A number of Directors cautioned that these changes could well raise problems in interpreting financial developments and in executing monetary policy, and they stressed that the Fund should be vigilant to developments in this area. In this connection, a number of Directors encouraged the staff to give a high priority to further work in the area of banking statistics, in close collaboration with national authorities and other international bodies.

Directors suggested that there was a need for close coordination among supervisory authorities--including regulators of securities markets as well as banks--in the period ahead, building on work that had been undertaken in such areas as banks' off-balance sheet business. Some Directors added that it was important that official support arrangements should not operate in ways that weakened market discipline and responsibility. They agreed with the staff that market discipline could operate more effectively in a stable financial environment.

Directors also noted that the changes in the markets had made countries' financial policies more interdependent, especially in the case of monetary policy. Improved policy coordination between countries, supported by Fund surveillance, was thus all the more necessary.

2. Developments in the debt situation

Directors expressed concern that lending by commercial banks has continued to run at very low levels. Indeed, bank claims on the 15 heavily indebted countries showed no increase in 1985 and declined by $3 billion in the first quarter of 1986. Directors, noting the deterioration in the terms of trade of debtor countries, particularly the oil producing countries, and the less buoyant growth prospects of the indebted developing countries, expressed concern about these developments and emphasized that banks must take responsibility for their contribution to the debt strategy and their participation in the Baker initiative. In particular, banks should not condition their contribution on magnitudes of official flows or on the availability of guarantees. A number of Directors deplored what they called the "wait and see" attitude of commercial banks and their reluctance to increase their exposure even in countries that had implemented forceful adjustment programs.

There was broad agreement that spontaneous private credit flows to developing countries are likely to continue at a low level in the near term. Some Directors were encouraged by the development of "semi-spontaneous" lending packages, involving a limited group of banks, for Côte d'Ivoire, Uruguay, and Ecuador, but were concerned that it might prove difficult for some countries with larger economies and declining terms of trade to achieve an early restoration of spontaneous lending from commercial banks. Thus, concerted financing was still indispensable in a number of cases. The forthcoming bank financing package for Mexico and concerted packages for certain other countries would provide a crucial test of the banks' commitment to the debt strategy. These packages and the coming on stream of important programs that have been negotiated in recent months were likely to result in larger concerted lending flows in late 1986 and 1987.

In discussing concerted financing many Directors expressed concern about diminishing cohesion in the banking community and noted that the treatment by the banking community of the issue of banks with small exposures had not advanced significantly since the previous Board review of the debt situation. Directors also agreed that the terms of bank financing needed to become more differentiated in light of countries' varying economic situations; this effort should be made on a case-by-case basis. MYRAs and, in certain cases, new money packages would be appropriate for countries that were better placed to resume spontaneous access to credit markets. For countries in more difficult circumstances, commercial banks would need to show imagination in fashioning financing packages that responded realistically to the prospects faced by these countries.

Several Directors called for greater burden sharing by banks, especially in the case of low-income countries that had embarked on comprehensive adjustment programs and were faced with extremely heavy debt burdens.

A number of Directors were concerned about the divergence in national supervisory, accounting, and tax regimes, which they considered had been a source of friction in the banking community. Some Directors also expressed concern about the growing tendency for supervisory authorities to differentiate between industrial and developing countries, and suggested that differences in income levels should not be a basis for prudential assessments. In addition, several Directors noted that problems could be caused by provisioning techniques that failed to make any distinction among countries that had rescheduled their debt with regard either to economic performance or to their record in servicing trade debt. A flexible attitude on the part of bank supervisors was seen as essential if new financing was to be assembled in support of growth-oriented adjustment programs. This is not to say that supervisors should be lax in their attitude toward banks; however, they should make their practices more consistent with the quality of the adjustment efforts of countries, whether or not the countries had rescheduled their debt.

Directors noted that capital flight was viewed as a serious problem in a number of countries. There was general agreement that the key to halting and reversing such flows lies in policies that would foster financial stability and soundly based growth. A staff study of this subject is expected to become available early in 1987.

Directors discussed the outlook for foreign investment and noted that the greater sharing of economic risks associated with such investment was seen as an advantage by a number of developing countries. Directors laid emphasis on policies--in both industrial and developing countries--as being the key to growth in direct investment. The recent liberalization in this field in a number of countries was welcomed. The Multilateral Investment Guarantee Agency (MIGA) launched by the World Bank also was seen as helping to stimulate such flows, and the potential contribution of the IFC in the area of equity investment was also stressed. The schemes for debt equity swaps and, in particular, the arrangements for the conversion of debt to equity in Chile, were welcomed. Such arrangements could make a contribution to solving the debt-servicing problems of these countries.

International bond issues to developing countries doubled in 1985 to some $10 million in gross terms, although developments in 1986 have been much more subdued. Most of these issues have been initiated by a few Asian and European countries.

Many Directors commented on the prospects for the volume and nature of lending by multilateral development banks and the role that these banks could play in resolving the present difficulties. They welcomed the sharp increase in recent months of commitments of fast-disbursing, policy-based lending of the World Bank, particularly to highly indebted countries. They also noted that greater attention was being paid by the regional development banks to the importance of economic policies. Directors emphasized that financing by multilateral development banks should not be a substitute for commercial bank lending. They stressed the importance of the World Bank's involvement in catalyzing a flow of external financing for debtor countries, particularly financing in support of structural reforms.

A number of Directors commented on the relatively rapid growth of officially supported export credits in 1984-85, compared with the very slow growth of unguaranteed bank credits. They also mentioned, in this connection, the relief on both principal and interest payments provided through official reschedulings in the Paris Club and pointed to these developments as added reasons why commercial banks should be urged to make a significant contribution to the debt strategy. A number of Directors welcomed the increased efforts of the Paris Club to tailor reschedulings to individual country situations so as to facilitate, where possible, the maintenance or resumption of export credit flows. The recent understandings on cut-off dates and on resumption of cover for countries under a rescheduling were seen as very positive developments.

Directors reiterated that the Fund should continue to play a central role in helping countries to solve their debt problems by encouraging the adoption of growth-oriented adjustment policies and by providing financing in support of these policies. The quality of these policies would be the key factor in catalyzing sources of external financing. With regard to enhanced surveillance, Directors emphasized that this procedure could succeed in its objective of facilitating a return to credit markets only when countries showed persistence in implementing appropriate policies and when creditors were vigilant in assessing countries' policies. A number of Directors suggested that the Board should return to a specific discussion of enhanced surveillance when some further experience had been gained. Directors agreed that Fund management and staff should continue to review carefully clauses in bank loan documents and should seek modifications where these documents were inappropriate in the light of, or prejudged, Fund policies and decisions.

In reviewing the general outlook for the debt situation and for flows to developing countries during the period ahead, many Directors commented on the challenges that the Fund would face in extending the progress so far in solving countries' debt-servicing problems. Since the outlook for spontaneous private lending was seen as unencouraging for these countries, at least in the short term, Directors considered that--in a number of cases--coordinated packages would be needed to ensure that the finance was not lacking for countries to pursue growth-oriented policy reforms. They stressed that adequate access to Fund resources and close collaboration between the Fund and the World Bank would be essential both to secure a return to growth in developing countries and to help catalyze external financing in support of appropriate macroeconomic and structural policies. The package in preparation for Mexico was a manifestation of such collaboration. Directors stressed the importance of obtaining adequate assurances from private creditors of their support for this package. It was noted that the Board would have the opportunity to discuss the implementation of the debt strategy based on a number of important cases in the coming months.

I have not commented extensively on general questions touched on by a number of Executive Directors today pertaining to the importance of the international environment for the debt problem, protectionism, world economic growth, coordination of economic policies, the terms of trade, interest rates, and official development assistance. These questions will be taken up more fully during the coming World Economic Outlook discussion.

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This concludes our annual review of developments in international capital markets. In reporting to the Interim Committee on developments in the debt situation I will pay close regard to the observations that you have made today and that you will make during the World Economic Outlook discussion, and I will draw on this summing up in indicating to the Governors the results of our discussions.

I have noted a general agreement among Directors that the staff papers on capital markets should again be published. The background paper on official debt restructurings would form a separate publication. The usual provisos regarding the deletion of sensitive material would apply. The paper on multilateral development banks would not be published; some factual material from this paper would be included in the publication on capital markets, subject to the agreement of the development banks concerned. I would ask Directors to give any further comments on the papers to the staff by September 19, with a view to facilitating early publication.