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July 23, 1985

To: Members of the Executive Board

From: The Secretary

Subject: The Role of the Fund in Assisting Members with  
Commercial Banks and Official Creditors

It is proposed to bring the attached paper on the role of the Fund in assisting members with commercial banks and official creditors to the agenda of the Executive Board on Friday, August 30, 1985. This paper will also serve as background material for the discussion on Colombia, scheduled for Friday, July 26, 1985.

Mr. Belanger (ext. 8671) is available to answer technical or factual questions relating to this paper prior to the Board discussions.

Att: (1)

INTERNATIONAL MONETARY FUND

The Role of the Fund in Assisting Members  
with Commercial Banks and Official Creditors

Prepared by the Exchange and Trade Relations Department

(In consultation with area departments,  
the Legal Department, and other departments)

Approved by C. David Finch

July 23, 1985

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The Role of the Fund in Assisting Members  
with Commercial Banks and Official Creditors

I. Introduction

This paper has been prepared in response to requests made by Executive Directors during the discussion of the Work Program on May 29, 1985. Specifically, the paper examines the basis and modalities of Fund involvement in debtor-creditor relations through the enhanced surveillance procedure and through the procedure proposed in the case of Colombia. Certain aspects of this subject were reviewed by the Executive Board during its discussions of "Developing Countries' External Indebtedness to Commercial Banks" (SM/85/61, 2/20/85 and Supplement 1, 3/6/85; EBM/85/46, 3/20/85), "Developing Countries' Indebtedness to Official Creditors" (SM/85/62, 2/20/85; EBM/85/46, 3/20/85), and "Enhancing the Effectiveness of Surveillance: The 1985 Annual Review of the Implementation of Surveillance" (SM/85/65, 2/22/85; EBM/85/49, 3/25/85).

The paper is organized as follows: Section II describes the background to recent developments in this area, including a review of the basis for the Fund's involvement in a member country's relationships with its commercial bank and official creditors through the enhanced surveillance procedure. Issues concerning the implementation of enhanced surveillance are reviewed in Section III. Another kind of Fund assistance was requested by Colombia; the special procedure proposed in that case is discussed in Section IV. A summary and some conclusions are set forth in Section V. An Annex provides background information on the monitoring procedures developed by creditors in connection with the multiyear restructurings negotiated with Mexico, Venezuela, and Ecuador. 1/

II. Recent Developments

1. The Fund's involvement in member country relations with creditors prior to 1982
  - a. Debt restructuring

During the years before 1982, procedures evolved for dealing with the debt-servicing difficulties of member countries in a multilateral framework. In the case of official creditors, debt rescheduling generally took place under the aegis of the Paris Club, which developed an accepted set of practices and procedures. In the case of commercial bank debt restructurings, while no formal framework evolved, procedures were

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1/ The detailed arrangements for the monitoring of performance under the economic program of Colombia are set out in EBS/85/149, Supplement 1 (6/14/85).

developed under which the debtor country held multilateral meetings with banks, frequently conducted with the assistance of the monetary authority of the country of the major creditor banks. Leading bank creditors often worked with the debtor country as it developed proposals for refinancing or for formal rescheduling of its bank debt.

Debt relief was generally provided by both official and bank creditors through the restructuring of maturities falling due during a limited future period and, when necessary, of arrears. Both official and bank creditors generally made debt reschedulings conditional on approval of a Fund-supported financial program. Adoption of a Fund-supported program was seen by these creditors as providing assurance that the country was committed to adequate adjustment policies, which would result in a return to a sustainable external payments position and, thereby, to a normalization of its relations with creditors.

In the case of official creditors, systematic links evolved between rescheduling procedures and Fund-supported adjustment programs. Considerable background information and the staff assessments of debtor country prospects, which were contained in Fund documents, were available to participating creditor governments who were members of the Fund. Furthermore, Fund staff generally attended Paris Club meetings as observers. For the initiation of debt renegotiations with a Fund member, official creditors traditionally required, as a precondition, the conclusion of an upper credit tranche arrangement with the Fund. However, the implementation of the rescheduling agreement generally was not formally linked to the observance of performance criteria under the Fund arrangement.

In the majority of cases, official rescheduling covered debt-service obligations--both principal and interest--falling due over a period of one year or only slightly longer. In some cases, however, official creditors also considered at the initial meeting the possibility of rescheduling in one or more subsequent years. In such cases, two alternative approaches were developed. Future reschedulings agreed at the initial meeting could take effect automatically without a further meeting of creditors, provided specified conditions were met. These conditions normally included a requirement that a new Fund arrangement be in place or that the conditions under which a country could purchase during successive years of a two- or three-year Fund arrangement had been established. The alternative, and more common, approach involved the use of a goodwill clause under which creditors agreed in principle to meet to consider further reschedulings, provided, *inter alia*, that a Fund arrangement was in place.

Bank debt restructurings also were generally conditioned on adoption of a Fund-supported adjustment program. The consolidation period generally stretched no more than one year into the future. Implementation of the restructuring was not tied to the observance of performance criteria under the Fund arrangement. In the case of bank creditors, interest payments were usually not rescheduled.

Thus, the arrangements which evolved for handling debt restructurings with official and bank creditors were broadly parallel, and the Fund in each case played a central role in creating confidence in the countries' adjustment policies. This role related primarily to the initiation of such policies, rather than to the monitoring of economic performance during the consolidation period. However, formal agreement with commercial bank creditors, or the signing of bilaterals in the case of official creditors, were on occasion jeopardized where noncompliance with the program came to the light before signing was completed.

b. New money for countries engaged in debt restructuring

The staff paper on "Fund Relations with Commercial Banks" (SM/77/130, 6/7/77) discussed the possibility that bank creditors engaged in debt restructuring for countries experiencing payments difficulties might link disbursements under refinancing arrangements or disbursements of new money to continuing performance under a Fund-supported program. The paper noted also that bank debt problems would pose complex administrative and regulatory issues:

Undoubtedly, the resolution of such debt problem situations will be increasingly complicated by the large number of creditor banks involved. It has to be recognized that occasions could arise in which the payments outlook is so adverse that it will be difficult for banks whose interests may well be divergent to hold together in a common approach. This will be particularly true if regulatory authorities in any of the creditor countries should adopt rules which add to the pressures for divergent reactions. It will undoubtedly be helpful if the monetary authorities of the main creditor countries reach an understanding on the procedure they favor. From present indications, it would seem appropriate for them to encourage their banks to undertake to cooperate with a call for ad hoc meetings between the banks and the debtor country. Such meetings might, on occasion, need the sponsorship of the major creditor monetary authority.

It further indicated that Fund/staff involvement might become necessary to help catalyze a resumption of external financing:

It is to be expected that in most meetings of this type, the Fund staff would be invited to assist. . . . The staff would regard any contribution it could make to the achievement of reasonable arrangements as worthwhile in the light of the consequences which could come from a failure to agree. The flow of bank loans is now so important to Fund members that major unresolved disputes could cause a hesitation in new lending, leading to serious adjustment difficulties.

The financial relief provided by restructuring payments due to official and bank creditors generally was sufficient to close the ex ante financing gap of debtor countries as they adopted Fund-supported adjustment programs. During this period, it was an exception for the Fund to seek prior commitment or informal assurance that new funds would be advanced by creditors in order to assure that the financing assumptions of the program were realistic (e.g., Jamaica, Turkey).

Little net additional lending occurred during the consolidation period for most of the countries that requested debt restructuring. In the case of official agencies, financing in the form of new export credit insurance cover, which often was interrupted during the rescheduling process, could resume after an interval, provided that adjustment policies were satisfactory and prospects of economic progress were good. Typically, decisions on cover resumption were taken bilaterally rather than multilaterally, subject to creditors' national policies and standards. Such official decisions may have been based, inter alia, on information contained in Fund staff reports, which were available to the agencies or their parent authorities. Thus, while these decisions were not formally linked to Fund arrangements subsequent to rescheduling, economic performance under such arrangements may have been an influencing factor. When there was no follow-up arrangement to use Fund resources, official creditors had access to Fund staff assessments of policies and prospects of the debtor country contained in periodic Article IV consultation reports. In some cases, covenants in loan contracts with commercial creditors specified that the debtor country would provide Fund documents to commercial creditors. <sup>1/</sup>

c. Countries which did not restructure their debt

In addition to those cases where debt restructuring occurred, there were other situations in which creditors incorporated the Fund's appraisal of countries' policies into their decisions on whether to proceed with financing. Cases occurred where bank creditors had serious concerns about the adequacy of a country's economic policies, even though the country's situation did not deteriorate to a point where debt restructuring was required. In a number of such cases, countries adopted a Fund-supported program in part to reassure bank creditors about the appropriateness of their adjustment policies, and thus to maintain their access to spontaneous market financing. On occasion, banks delayed new lending until the country obtained an upper credit tranche arrangement from the Fund, and in some cases they linked lending decisions to countries' relations with the Fund in "parallel operations." The 1977 paper on Fund relations with commercial banks (SM/77/130, 6/7/77) described such arrangements as follows:

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<sup>1/</sup> Available information on restructuring agreements with 19 countries since 1979 indicates that staff reports were to be made available to banks on at least one occasion in 14 cases.

. . . The operative practice has been to tie the banks' operations to Fund financial transactions, thus ensuring that the banks have objective assurance that the Fund is sufficiently satisfied with the adjustment measures that it is willing to commit its own resources. Such parallel operations are now growing in frequency.

. . . Parallel operations have, of course, no precise definition. In some cases banks have merely followed the announcement of a Fund stand-by arrangement with a loan of their own. But in a number of cases, the banks have wished to have a more specific assurance that the appropriate adjustment policies are not only announced but also are being implemented over time. Consequently, some large banks have come to know more about the details of Fund policies in the credit tranches. They have learned to distinguish between a first credit tranche program with its lack of performance clauses and the higher tranche stand-by arrangements with phased drawings and performance clauses. On occasion, therefore, they have delayed their lending until the country has a stand-by arrangement in the higher tranches and have related their own lending to continued observance of the performance clauses in that program.

. . . In the light of the increasing problems of payments adjustment at present, the staff would expect the interest of banks in parallel operations will continue to grow in the immediate future.

In cases where the member was in compliance with the Fund-supported program but did not make purchases, alternative techniques were developed to inform creditors of that compliance. In some cases, under direct authorization of the member, the Fund staff would disclose to creditors whether the member was eligible to make purchases under the program. More frequently, banks would obtain information on compliance directly from the authorities; sometimes written confirmation was provided by the Fund staff to the monetary authorities for onward transmission to creditors.

In all of these cases prior to 1982 in which bank creditors linked their disbursements to purchases from the Fund, they relied on the Fund to continue monitoring the debtor country's economic performance. For the bulk of their lending, however, bank creditors did not rely on endorsements by the Fund of debtor countries' policies when making financing decisions. Indeed, where countries were not implementing a Fund-supported program, there was no provision for the Fund's appraisal of the adequacy of the countries' policies to be transmitted to bank creditors. Official creditors, of course, received the Fund's appraisals, as reflected in staff reports, in the summings up of Board discussions, and in special reports or briefings held in connection with aid consortia meetings for many countries. However, such information may not always have been available systematically to all official agencies involved in financing decisions.

2. Response to the emergence of widespread debt-servicing difficulties in 1982

Significantly different modalities of Fund involvement in debtor-creditor relations were developed starting in 1982. With the widespread payments difficulties that emerged in 1982-83, countries engaging in debt restructurings and adjustment programs often were unable to secure spontaneous new lending. The potential relief provided by bank and official debt restructurings alone left a gap so large in relation to what the Fund could contribute that means had to be found to raise sufficient additional financing to close the ex ante financing gap confronting a number of debtors. In principle, additional adjustment measures by countries could have been envisaged to close such financing gaps. In these cases, however, there was a serious concern about the economic and social impact of more rapid adjustment.

In these circumstances, the Fund had to be more active in assisting member countries in mobilizing the necessary finance. Since commercial banks had been the major source of funds in many cases, this required that the Fund collaborate with banks in working out an orderly response. The "concerted lending" approach was inaugurated against this background in the cases of Mexico and Argentina in late 1982. <sup>1/</sup> Concerted lending permitted, in some cases, not only full refinancing of maturities falling due but also mobilization of new lending on a scale often several times the amount that the Fund could provide on its own.

In this connection, certain practices evolved. In particular, as a result of the need to assure the viability of the adjustment program, banks were asked to make a commitment to finance the ex ante gap before management would seek Fund approval of a country's request for use of Fund resources. Bank advisory committees thus needed to assemble the critical mass of commitments necessary to help finance a country's adjustment program. As part of this effort, a telex from the Managing Director was sent to the international banking community indicating the Fund's support for the country's adjustment program, as evidenced by Management's acceptance of a letter of intent, and encouraging banks to commit themselves to a new money package.

As part of the efforts to assemble the critical mass necessary for concerted lending, Fund staff, at the request of the debtor country authorities, have shared with creditor banks information about policy measures undertaken and the broad policies to be pursued under the Fund-supported programs, and have discussed the implication of alternative

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<sup>1/</sup> The term "concerted lending" is used in a very general sense in the paper to refer to an organized and collective effort on the part of commercial banks, official creditors, and the Fund to secure commitments to close an ex ante financing gap for a member country. Commitments could include assurances to agree to rescheduling as well as to the provision of new money.

levels of financing. This information was supplied to the creditor banks to assist them in making their financing decisions. For their part, banks generally have linked disbursements of concerted lending to purchases under Fund arrangements. Thus, banks were provided an indication that the debtor country was making progress toward a viable payments position by its continued ability to make purchases under the arrangement with the Fund. In this regard, banks were able to obtain continuing on/off indications from the Fund.

The relationship between the Fund and official creditors which emerged in 1982 involved certain other new features in response to the debt difficulties. These new features did not necessitate basic changes in the Fund's dealings with official creditors, since existing links with those creditors had already been more systematic than those with banks. Since 1982, however, there have been closer informal communications and exchanges of view among the official creditors, the debtor countries, and Fund staff, occasionally at earlier stages of the debt rescheduling process than previously. In circumstances of exceptional financing need, advanced staff consultation with Paris Club creditors has proved helpful in clarifying the technical issues involved, particularly the economic implications of alternative levels of debt relief. Official creditors have, in turn, demonstrated their willingness to respond flexibly in view of the needs and prospects of individual countries.

In a few cases, Fund arrangements have been approved only "in principle" before a rescheduling meeting of the Paris Club because of the uncertainty and the scale of the needed external financing. In these instances, official creditors relaxed somewhat their longstanding requirement of a Fund arrangement as the precondition for the meeting, and the absence of outright approval of the Fund arrangement did not prevent the satisfactory conclusion of an agreement on the terms of the rescheduling. 1/

Concerning new financing and the resumption of export credit cover, for the majority of cases, official creditors retained their traditional approach of sovereign decision-making on a bilateral rather than multi-lateral basis. Nonetheless, cover policy decisions have become rather more flexible since 1982, as reflected particularly in the virtually universal readiness across export credit agencies to maintain cover for short-term trade finance, provided certain conditions were met. Also, on a case-by-case basis, the Fund management has sought from governments

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1/ In the Chairman's Concluding Remarks at the Conclusion of the Executive Board's discussion of "Approval in Principle" (EBM/84/155, 10/24/84) it is noted that "in order to minimize the use of approval in principle, management and staff should undertake in each case intensive consultations with all creditors so as to seek reasonable assurances on the financing of the program. Where such reasonable assurance had been reached, outright approval would continue to be the normal procedure."

that were concerned to provide exceptional assistance for certain major borrowers indications as to export credit financing arrangements that could be made available in parallel with concerted bank lending. These arrangements, however, were made in an informal framework, with close collaboration with authorities in major creditor countries, and in the context of a Fund-supported adjustment program for the country concerned.

3. Recent initiatives to restore countries' access to credit markets

By mid-1984, it had become evident that some countries that had achieved significant domestic and external adjustment and had demonstrated their ability to dispense with additional concerted financing, were nonetheless confronted with a bunching of amortization payments so sizable as to present an obstacle to restoring their normal access to credit markets. In this regard, there was a need to make further progress in resolving debt-servicing difficulties, and to extend the strategy pursued since the emergence of the financial crisis in 1982 by encouraging a medium-term perspective in debt restructurings. Multiyear restructuring agreements (MYRAs) offered the prospect of eliminating the "hump" in the debt amortization profile of countries that had achieved substantial adjustment. By shaping a more realistic debt-servicing profile, and by providing a clearer planning horizon for creditors and investors as well as for the debtor government, MYRAs were seen as permitting a return to normal financial market relations.

The multiyear restructuring exercise was launched at the International Monetary Conference in Philadelphia, on June 4, 1984, when the Managing Director met with the Chairmen of the commercial banks participating in the Advisory Committee for Mexico to examine the possibility of a multiyear restructuring of Mexico's bank debt. The commercial banks' communique at the monetary conference indicated their intentions to start negotiations toward such an arrangement.

Shortly after Mexico had initiated discussions with its bank creditors on a multiyear arrangement, the heads of state of seven industrial countries issued a communique which, inter alia, stated that particular importance was attached to encouraging more extended multiyear reschedulings of commercial debts in cases where debtor countries were making successful adjustment efforts and to standing ready, where appropriate, to negotiate similarly in respect of debts to governments and government agencies.

a. Mexico

A multiyear rescheduling of Mexico's bank debt was essential to achieving a transition from annual debt restructurings and "concerted lending" toward more decentralized and market-based financing decisions by creditors. For their part, banks were concerned to improve their ability to monitor the economic performance of the country and to establish mechanisms by which they could reunite in a steering committee

or in some other forum should economic conditions deteriorate. Under the MYRA agreement with its creditor banks, Mexico agreed that it would make more economic information available directly to banks and also decided to request the Fund to increase the frequency of Article IV surveillance of its economy and to make copies of Fund staff reports on these consultations available to the banks. The concern on the part of bank creditors for more timely information and analysis has also been addressed through the implementation of procedures which at the same time serve to improve the availability of economic information to domestic policymakers.

The procedure of enhanced surveillance was developed in this context. The key objectives of the arrangements were to improve the country's capacity to design, implement, and monitor economic policies and to provide information about those policies to creditors; to support banks' risk evaluation through timely and comprehensive information and through the Fund's forward-looking assessment of domestic policies; and to foster a shift in responsibility for lending decisions back to commercial banks by avoiding on/off financing indications from the Fund. At the outset of the MYRA, because of the quality of the adjustment underway and in view of the desirability of dealing with the "hump" problem, the Fund did provide a positive indication in support of concluding such an agreement.

The arrangements requested of the Fund by the Mexican authorities foresee that the Fund will conduct semiannual consultations. The annual Article IV consultation report will review and appraise the adequacy of a quantified financial program prepared by the country's authorities, commenting specifically on the internal consistency of its objectives and targets, and addressing their compatibility with sustained growth and the attainment of a viable external payments position. Interim consultations will address the progress achieved in implementing the financial program and evaluate the country's economic performance on the same basis as annual consultations. Enhanced surveillance will follow the present extended arrangement (which expires at end-1985) and will continue through 1990 or 1994 (depending upon the date of final repayment of Mexico's 1983 new money package).

These arrangements in support of the MYRA with commercial banks are intended to facilitate Mexico's return to more normal market access. While the Fund staff will make an assessment of the country's program and review actual developments, creditors will need to weigh that information, together with other available information, before arriving at a judgment about the economic performance of the country and before making their lending decisions. In the event that Mexico's economic situation or prospects deteriorate such that it would be unable to meet its financing requirements through normal market channels, it has covenanted to seek financing from other sources, which may include a request to use Fund resources.

During the period of the arrangements, creditor banks party to the restructuring agreement can call an event of default if they determine, based on the comments and conclusions expressed in the annual or mid-year consultation reports, that the implementation of Mexico's financial program is materially incompatible with the country's sound and sustained economic growth and with a viable external payments position consistent with a continuing ability to service external debt. An event of default could also occur if the consultation and reporting procedures were not carried out as described; or if the average level of certain foreign liabilities falls below a specified figure. In addition, three years of the Mexican consolidation period (1985-87) have been "carved out" for a block rescheduling; there is specific provision for the possibility that creditor banks may discontinue the restructuring beyond that point if they decide that Mexico's policies are inadequate. <sup>1/</sup>

b. Venezuela

The arrangements for monitoring Venezuela's economy closely parallel those adopted in the case of Mexico. However, Venezuela's initial adjustment effort was undertaken without a request to use Fund resources. Consequently, enhanced surveillance commenced with the Executive Board's first review of Venezuela's policies during the Article IV consultation on May 30, 1985. It is to extend through the amortization period of the debt restructuring (i.e., 1997). The Venezuelan MYRA reschedules a complete block of maturities falling due during 1983-88. Thus, unlike the case of Mexico, there is no specific provision for a date on which banks may vote to discontinue the restructuring. At any time, however, two-thirds of the banks (weighted by exposure) could call an event of default if "in their reasonable judgment, the results of Venezuela's economic program are or will be materially incompatible with a viable external payments position consistent with continuing debt service." In addition, should operating reserves of the Central Bank fall below US\$2 billion, an event of default would occur.

c. Ecuador

The commercial banks' arrangements with Ecuador for monitoring its economy also are similar to those concluded with Mexico, although Ecuador is expected to be under stand-by arrangements through both 1985

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<sup>1/</sup> The rescheduling agreement provides that a majority of banks having more than 55 percent of the original commitments under the 1983 new money package is required to arrest the rescheduling, but that banks having 33 percent of the commitments may trigger a vote on this issue. On the one hand, the provision for a minimum initiating group of votes protects the debtor country from disruptive actions by individual creditor banks. At the same time, the reference to 33 percent of the commitments has been interpreted as an indication that the bank advisory committee (which held approximately one third of the votes) might continue to exercise some form of monitoring role.

and 1986. Enhanced surveillance would begin in 1987, and run for ten years to the final amortization payment of the restructured debt. The consolidation period will end in 1989. After 1986, the restructuring is "serial," insofar as there is explicit provision for a majority of banks to arrest the restructuring in any year if Ecuador's financial program is judged inadequate by the banks, or if its external situation or prospects deteriorate. This provision is in addition to the events of default, which could end the restructuring at any time if the majority of lenders determine, based on the comments and conclusions expressed in the annual and midyear consultation reports, either that the implementation of Ecuador's economic and financial program is or would be materially incompatible with a viable external payments position consistent with a continuing ability to service external debt, or that there has been a deterioration in the economic position of Ecuador. An event of default could also occur if the consultation and reporting procedures were not implemented in the manner described.

In April 1985, Ecuador also reached agreement with its official creditors on a multiyear rescheduling, which covered the three-year period through end-1987. This was the first time in recent years that official creditors have granted a rescheduling covering several years that was not strictly linked to the existence of a Fund arrangement in each of those years. In particular, the agreement provided that the third tranche of debt relief in 1987 will be conditional either upon Ecuador having a Fund arrangement or upon specified enhanced surveillance procedures. Under the latter option, such rescheduling will become effective provided, inter alia, that the creditors have reached a positive assessment that Ecuador has set forth in the process of consultation with the Fund and is implementing a comprehensive and satisfactory economic program, including quantitative quarterly targets, covering the period through the end of the consolidation.

In deciding to grant a MYRA to Ecuador, official creditors attached importance to the fact that Ecuador's external position was expected to be sufficiently strong to enable it to finance the current account of its balance of payments without concerted action by creditors, and without rescheduling of interest. In view of the objective that a MYRA should provide a transition to normal debtor/creditor relationships, official creditors also considered it important that the percentage rescheduled decline over time. The agreement, therefore, provided for the rescheduling of principal only, with the percentage rescheduled declining from 100 percent in 1985 to 85 percent in 1986 and to 70 percent in 1987.

d. Other member countries

Commercial banks currently are discussing MYRAs with Brazil, Yugoslavia, the Dominican Republic, and Jamaica. In the first two of these cases, the Fund has been informed of the country's intention to request enhanced surveillance in the period following arrangements to use Fund resources.

#### 4. An overview

The recent experience of the Fund's involvement in member countries' relations with their creditors reviewed in the previous sections demonstrates the catalytic role the Fund has played in promoting capital flows in support of members' adjustment efforts. The adoption of an adjustment program supported by the use of Fund resources and progress in the achievement of adjustment objectives often provides the required basis for resumed lending by other creditors. This catalytic role of the Fund has included assistance to the member in presenting its case to creditors, including within the framework of the Paris Club or a similar forum in the case of official creditors, or through contacts or meetings with steering committees or economic subcommittees in the case of commercial lenders. The Fund staff has played a similar role in cases not involving the use of Fund resources by a member, e.g., in the context of meetings of aid groups, often in cooperation with the World Bank. However, recent developments in the exercise of the Fund's catalytic role clearly represent different modalities of Fund involvement.

In the first stages of adjustment to the debt crisis, the immediate aim was to prevent an escalation of difficulties into a generalized breakdown of financial relations and a retreat by debtors behind a wall of restrictions and controls. The key element in that strategy was the adoption of firm adjustment programs in debtor countries supported by appropriate financing from official and commercial sources. A major responsibility of the Fund was to ensure that the various components of this cooperative effort were consistent and were put in place quickly. In these circumstances, Fund involvement through the implementation of its traditional policies for the use of its resources was clearly both appropriate and essential. Fund approval of an arrangement and subsequent monitoring of the members' policies provided both the Fund and other creditors with the needed assurance that adjustment policies were being implemented. The involvement of management and staff in assisting debtor countries present their case to creditors and raise the financing needed to support their adjustment efforts was also intensified. Tying the approval of arrangements to financial commitments from creditors provided assurance that sufficient financing would be available.

Beyond the initial stage of crisis management, as adjustment policies have taken effect, a key objective has been to rebuild normal debtor-creditor relations. A prerequisite to the achievement of this objective is that gross financing requirements return to levels that can be accommodated through a resumption of spontaneous lending relations, including the provision of normal trade-related credits. In practice, this requires that any undue bunching in countries' amortization schedules, which may result, in part, from the earlier rescheduling of maturities for relatively short periods, be smoothed out, partly by extending maturities over a longer period. The cooperation of creditors in agreeing to multiyear restructuring arrangements was essential to

this process. A second prerequisite was that procedures had to be in place to promote continued implementation of appropriate adjustment policies by debtor countries; and to encourage creditors to be informed of and responsive to developments which could lead to a recurrence of the excessive borrowing by debtors and lending by banks which underlay the debt crisis.

The procedure of enhanced surveillance was developed to assist in this process of restoring normal market relations. Although commercial creditors generally would have preferred a continuation of the process of negotiation and support by the Fund for debtor countries' policies, the sequential approval of single or multiyear arrangements for the use of Fund resources, even precautionary ones, would have perpetuated a level of Fund financial involvement inconsistent with the aim of normalizing debtor-creditor relations and with the monetary character of the institution. However, too sudden and sharp a retrenchment of the Fund's involvement could have undermined the gradual recovery of confidence on the part of creditors. Also, avoiding a recurrence of excessive borrowing by debtors and lending by banks required an improvement in both debtor countries' financial programming and creditors' risk assessment procedures. In these circumstances, the enhanced surveillance procedure was seen as a way for the Fund to help in the process of normalization of market relations.

The terminology and certain techniques of enhanced surveillance are closely akin to those of surveillance. The activities of the Fund under enhanced surveillance, however, extend beyond the implementation of its responsibilities under Article IV. To some extent, the Fund provides a specific service, at the member's request, helping the member normalize its relationship with creditors. The authority of the Fund to carry on such procedures should thus be considered to take place primarily under Article IV, but also under Article V, Section 2, which empowers the Fund "if requested . . . to perform financial and technical services . . . that are consistent with the purposes of the Fund."

### III. Implementation of Enhanced Surveillance

Procedures for the exercise of the Fund's role in helping resolve members' and systemic debt difficulties have evolved rapidly as individual cases have emerged. Directors already had preliminary discussions on certain aspects of enhanced surveillance earlier this year as noted in Section I of this paper. While Directors recognized that the procedure of enhanced surveillance would doubtless evolve further with experience on a case-by-case basis, several key observations were supported by most Directors and have since guided management and staff. In brief, Directors emphasized that the Fund should be selective in acceding to requests for enhanced surveillance; that, under enhanced surveillance, the Fund should not be seen as either formally endorsing the member's policies or intervening too deeply in the relations between debtor

countries and commercial banks; and that commercial banks should take full responsibility for their country-risk assessments. Some Directors cautioned against the involvement of the Fund in such arrangements for too long a period of time. These issues, as well as others which have emerged since, are reviewed below in light of the experience gained through the first cases of enhanced surveillance.

1. Fund procedures

Three separate elements together comprise enhanced surveillance: a quantified financial program, prepared by the country's authorities, presenting a comprehensive description of the major macroeconomic objectives and the policies to be followed in their achievement; supplemental staff visits to the country concerned and supplemental staff reports and discussions of these reports by the Executive Board; and the release of staff reports by the member to banks.

Some of these elements of enhanced surveillance represent a further strengthening of improvements already introduced in the implementation of the Fund's traditional surveillance function.<sup>1/</sup> The focus of discussions on a quantified financial program prepared by the member, and the resulting greater transparency of the member's objectives and of the relationship of proposed policies to these objectives, could improve the Article IV consultation with other members as well. As regards the periodicity of staff visits and reports, while the one-year norm for Article IV consultations has generally been considered adequate, exceptionally, surveillance procedures already allowed for more frequent consultations in light of a member's special circumstances.

The release of staff reports to commercial creditors, however, is clearly exceptional. The possibility of members making staff reports available to commercial creditors was considered earlier. However, this was not generally supported by Directors because of concerns that such a practice could endanger the relationship of the Fund as confidential advisor to its members, possibly undermining the candor and frankness of policy discussions with members. For this reason, enhanced

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<sup>1/</sup> Partly as a result of the experience of the late 1970s-early 1980s, several modifications have since been introduced in the implementation of surveillance to improve its effectiveness. Besides increasing the regularity of consultations with members, these modifications have aimed at improving the analytical content of staff reports, sharpening their focus on external indebtedness, and giving increasing attention to the internal coherence and chance of success of the members' medium-term strategies. The systematic assessment of the medium-term implications of various policy strategies on global economic conditions, and the debt situation in particular, in the World Economic Outlook exercise has provided the broader framework needed for such assessments of the policies of individual members. The Fund has also collaborated with members and other international agencies to improve external debt data.

surveillance has been conceived as an exceptional and temporary adaptation of Fund procedures and practices, in response to equally exceptional circumstances. Enhanced surveillance involves, at the request of a member country, a process to make available to commercial creditors a communication between the Fund and the member that is normally confidential. As a temporary and selective arrangement, this is seen as appropriate to the special circumstances that have arisen. Other cases can be expected to arise in which a request for enhanced surveillance will be forthcoming from a member country and will be deemed appropriate by the Board. However, as a fuller adjustment to the emergency circumstances of the debt crisis is achieved, the success of enhanced surveillance itself, as well as the strengthening of the Fund's traditional surveillance function, should eliminate the need for these exceptional procedures.

In this connection, it should also be noted that the procedures for enhanced surveillance are not intended to, and do not, establish legal obligations for the Fund vis-a-vis commercial creditors. This point should be made clear in all cases to the parties concerned.

## 2. Criteria for the adoption of enhanced surveillance

The experience gained in the early cases of enhanced surveillance, together with the guidance provided by the Board and by the traditional relationship of the Fund with its members, have permitted the identification of broad criteria to apply in deciding whether to recommend to the Board acceptance of requests for enhanced surveillance. This section provides a summary of the criteria which are being employed by management and staff in cases now being considered.

The initiative to request enhanced surveillance must rest with the member which must be convinced that enhanced surveillance procedures are suited to its circumstances. The member must be satisfied that, given the amortization schedule facing the country as determined, for example, by prospective or already agreed MYRAs with commercial and official creditors, spontaneous financing will be sufficient to allow for a continued orderly adjustment of its balance of payments. The need to use Fund resources or other exceptional or new concerted lending to bridge a financing gap would require a much closer level of cooperation between the member, its creditors and the Fund than is consistent with procedures envisaged under enhanced surveillance. Of course, creditors need also to be satisfied with the strength of the member's commitment to its adjustment policies and with the adequacy of mechanisms for them to monitor future progress.

Acceptance by the Fund of the member's request for the enhanced surveillance procedures is a decision for the Fund to take, based on criteria which it considers appropriate. A first criterion must be that the member has already achieved an impressive record of adjustment. While a member might request enhanced surveillance in the expectation that it would facilitate its relations with banks, it is important for

the Fund to explore with the member whether or not this expectation is realistic. The record of the member's achievement should provide the Fund with some assurance that adequate policies are likely to be maintained. Without this, enhanced surveillance might not facilitate the member's relations with banks in the long run.

A second criterion, closely related to the first, is that the debtor country should have completed a sufficient part of the required adjustment so as to limit its need for net external financing over the foreseeable future to amounts that can, with confidence, be expected to be forthcoming spontaneously. Beyond the initial relief provided by the multiyear restructuring, spontaneous bank lending should be sufficient to meet the member's financing requirements.

A third criterion is that the member must be able to present a fully articulated and quantified policy program enabling both the Fund and creditors to assess the member's adjustment objectives and the consistency of these objectives with intended policies, and to monitor progress under the program. The processes of formulation, assessment, and presentation of such a program will provide a basis for improving the member's economic and financial programming, the creditors' risk assessment procedures, and the ability of each to better satisfy the needs of the other in an ongoing financial relationship. These elements are critical to a strengthening of the international financial system. Particular attention must be paid in this context not to confuse the form and substance of enhanced surveillance. The quantified program must be an integral part of the debtor country's policy-making process, truly reflecting the country's objectives and policy intentions. Moreover, the creditors must be full and active participants in the process of monitoring and assessing the policies of debtor countries and the progress achieved in their implementation, and must take full responsibility for their lending decisions; they must not rely on "on/off" signals from the Fund. Should debtor countries or creditors confuse the form and substance of enhanced surveillance, the Fund should not be a party to such self-deception.

A fourth criterion is that enhanced surveillance should benefit the member by promoting improved market relations. In practice, cases in which enhanced surveillance has been proposed have been linked to debt restructuring within a multiyear framework of the large "humps" of amortization payments which otherwise would have required successive annual renegotiations of their debt. In these cases, the creditors' decision to proceed with the multiyear rescheduling has been made conditional on acceptance by the Fund of enhanced surveillance. Clearly, enhanced surveillance, if the member's circumstances satisfied the first three criteria, could be of benefit both to the debtor country and, through its effect on the international financial system, other members as well.

While interpretation of the first three criteria is relatively straightforward, although judgment is obviously required in each case, this last criterion could give rise to particularly difficult issues. A key objective of the Fund is to promote normal, albeit more soundly based, financial market relations. The Fund must thus strive to limit its involvement between the debtor country and its creditors. As normalization progresses, the range of Fund involvement necessary to support this progress should narrow substantially, allowing the Fund to revert to its traditional role in the confidential relationship with members. However, there could be a danger that, at least in the initial stages, creditors could try to pressure both the member and the Fund to broaden the Fund's involvement. So far, commercial banks have made enhanced surveillance a condition for MYRAs. Not all MYRAs, however, would necessarily require enhanced surveillance. The Fund could judge that the progress achieved in reshaping the debtor country's policies and in strengthening the policy-making process, and the information available to commercial creditors are such that enhanced surveillance procedures are not needed. However, limiting the Fund's agreement to enhanced surveillance only to cases where the Fund judges such a procedure to be essential may be difficult, especially if banks would attempt to over-represent the essential nature of Fund involvement and try to continue to make enhanced surveillance a condition of all MYRAs.

There is also a question of whether enhanced surveillance could be applied in cases not involving multiyear rescheduling. For example, enhanced surveillance could be requested as a follow-up to the use of Fund resources even though a multiyear rescheduling of maturities is not involved. It could be argued that enhanced surveillance could help achieve a gradual phasing down of the Fund's involvement in the relation between debtors and creditors. One risk of entering into the enhanced surveillance procedure in such cases, however, is that perceptions by banks could develop of a normal graduation process from conditionality to enhanced surveillance to normal market relations. Instances of one-step progression to normal market access could, as a result, become the exception rather than the rule and lead to prolonged, albeit looser, Fund supervision, effectively retarding rather than promoting the normalization of market relations.

Circumstances could also arise of enhanced surveillance being requested at an early stage of a member's balance of payments difficulties, possibly leading to use of Fund resources if trends or perceptions are not reversed. The Fund has always encouraged members to address their balance of payments difficulties at an early stage, and stands ready to support a member's efforts including, at the member's request, through the approval of arrangements (including precautionary ones) for the use of its resources. Several difficulties, however, could arise if enhanced surveillance were used as a substitute for an arrangement for the use of Fund resources in such circumstances. Enhanced surveillance by providing a first and looser form of Fund involvement could delay rather than promote the adoption of actions which are

sufficiently strong and comprehensive in the member's circumstances. In practice, a decision would be needed of whether Fund involvement through the negotiation of a program for the use of Fund resources would not be more appropriate. While the use of Fund resources is not a prerequisite for enhanced surveillance, a strong record of adjustment, as indicated earlier, must be.

Also, the release of staff analysis and appraisals to banks as part of enhanced surveillance should remain exceptional; the availability of this material through a less selective process could lead to substantial pressures on members to seek such arrangements at the first sign of market unease. Such a development runs counter to the confidential communication between the Fund and a member. Moreover, it could increase perceptions of Fund "tutelage" and of a collusion between the Fund and banks, resented as such by members pressured into enhanced surveillance by their creditors, thus undermining the basis for cooperative dialogue between the Fund and its members. Finally, the ready availability of enhanced surveillance procedures for cases considered to represent lesser commercial risks could also narrow the range of members using Fund resources to only those with severe balance of payments difficulties. In these circumstances, the request for use of Fund resources could become perceived by financial markets as providing a clear signal of severe difficulties.

In sum, the willingness of the Fund to enter into enhanced surveillance in the case of countries where a strong adjustment effort has taken place has played an important role in helping to accelerate the process of transition to more normal market relations. Enhanced surveillance in appropriate cases has been essential to secure creditors' agreement to multiyear rescheduling and should continue to be available in these circumstances. A widening of the range of application of enhanced surveillance, however, could result in an inappropriate involvement of the Fund in the relationship between debtors and creditors, retarding rather than promoting normal market relations; create risks that members may be pressured by creditors into requesting enhanced surveillance; and delay rather than promote effective adjustment.

### 3. Involvement of the Executive Board

The process of approval of enhanced surveillance is similar in many respects to practices followed in cases of use of Fund resources: management's decision to propose a member's request for an arrangement for the approval of the Board is based on guidelines and policies agreed by the Board; approval follows consideration by the Board of the member's request. In the case of enhanced surveillance, management initiates the procedure in response to the member's request; again, the granting of the request is subject to the endorsement of the Board. Nevertheless, while mechanically or sequentially similar, there have been differences of substance in procedures relating to the fact that guidelines and policies have not yet been nearly as well defined in cases of enhanced surveillance as in cases of requests for an arrangement for use of Fund resources.

An important criterion for management to proceed with a member's request for enhanced surveillance is the record of the member's adjustment. Clearly, Directors' views, expressed on the occasion of earlier considerations of the member's request for use of Fund resources or of Article IV consultations with the member, provide guidance to management and staff in making this assessment. Nevertheless, while the record of adjustment provides some assurance of the member's commitment to sustain appropriate policies, a fuller assessment clearly requires an analysis of the most recent developments and prospects. Thus, the Board's endorsement should be made within a short time after management's decision to propose Board approval of the member's request and at a time when the Board has before it a full report on the most recent developments. Since enhanced surveillance and MYRAs have been so closely interlinked, approval by the Board of the member's request would also constitute endorsement of management's communication to creditors supporting the MYRA in the member's circumstances. These elements of the Board's deliberations would be reflected in the Managing Director's summing up.

The role of the Executive Board in the application of the enhanced surveillance procedure is similar to that which it exercises in an Article IV consultation. Directors' views, not the staff report, constitute the views of the Fund, through which the general membership exercises its influence on the policies of individual members. In those discussions, the Executive Board assesses the appropriateness of (and, thus, guides) the staff's analysis and appraisal of members' policies. Supplemental staff visits and the more frequent consideration by the Executive Board in the context of enhanced surveillance of progress in the implementation of a member's policies will involve an even more active and continuous role for the Board.

An issue raised by several Directors concerns the nature of the views communicated to creditors. So far, only staff analyses and assessments have been considered for transmission to bank creditors. The issue has been raised whether the views of the Board should be transmitted in addition to staff views, especially since in some cases the views of the Board could differ from those presented in the staff reports. The risk, however, should be considered in this context that a wider circulation of Board views could increase the possibility of leaks. This question thus raises to some extent issues similar to those noted earlier in the context of Board consideration of the broader issue of the publicity of Fund proceedings, in particular as regards the need to protect Directors' freedom in expressing their views. Nevertheless, Directors may wish to consider whether the special nature of enhanced surveillance warrants that their deliberations should be made available to banks.

4. Other modalities of Fund involvement

a. Content and distribution of staff reports

Proposals for enhanced surveillance have envisaged, during the annual Article IV consultation, discussion of a quantified financial program, prepared by the country's authorities, which would present a comprehensive description of the major macroeconomic objectives for the year and the policies to be followed for their achievement. Staff reports are expected to provide a frank analysis and appraisal of the authorities' objectives and of the consistency of proposed policies with these objectives. However, in accord with the objective of promoting the normalization of market relations, while staff reports should present a frank assessment of policies and prospects in the member country to assist creditors in making their decisions, the procedures should not be such as to provide automatic signals for creditors' lending decisions similar to those when creditors link their disbursements to purchases under a Fund arrangement.

While Directors have welcomed the fact that staff reports in the early cases of enhanced surveillance have avoided the appearance of endorsement by the Fund, or on/off signals to creditors, Directors have raised several specific issues regarding the content and timing of staff reports and their distribution. First, several Directors were not satisfied that the reports had provided as complete an analysis as would have been appropriate. They noted in particular that the empirical and analytical basis of policy judgments should be made as explicit as possible, especially when differences of view were apparent between the staff and the authorities. Several Directors have also emphasized that a full-fledged Article IV consultation should initiate the process of enhanced surveillance. The supplemental or midterm review could then be focused on implementation of the financial program and developments in the key variables it was designed to affect.

A second issue concerns the authorization to the member to make staff reports available to its creditors and the distribution of these reports. The understanding has been that the documents envisaged include staff reports and, in the case of the regular Article IV consultation, the report on recent economic developments. A decision by the Executive Board (either a formal decision or as part of the Managing Director's summing up) needs to be taken in order to authorize the release of staff reports by a member to its creditors. This authorization could be provided by a general decision pertaining to all cases for which enhanced surveillance is agreed or in each individual case. In the initial cases of enhanced surveillance, the fact that the member intended to make the report available to creditors was noted in the staff report itself and the agreement of the Board to this procedure was indicated in the Managing Director's summing up of the discussion by Directors.

A related issue concerns the timing of the distribution of staff reports to banks. If the practice was adopted of also making available to banks the views of the Board, it would clearly be necessary to delay the distribution of staff reports until after the Board meeting. However, if the practice of making available only staff reports is accepted, a distribution to banks before the Board meeting should help strengthen perceptions that the views expressed are those of the staff, and the staff alone. An exception to this rule would be indicated in the case of the first staff report under enhanced surveillance for a member if the Board has not already approved enhanced surveillance, as circulation should appropriately be delayed until after Board approval of the procedure.

Several Directors have questioned in this context what the extent of circulation of reports would be, e.g., steering committee members only or all banks. MYRAs negotiated to date foresee access by all creditor banks to staff reports. Moreover, it should be recognized that once circulation has been authorized, it would not be possible for the Fund to limit the scope of "secondary" circulation. In this connection, it will likely be necessary to permit distribution of the reports by banks to organizations such as the Institute for International Finance (IIF) from which the banks may wish to solicit opinions about the views expressed by the staff. The Fund should not discourage such circulation of these reports since it will be critical for banks to organize themselves effectively to analyze the material made available to them and, where appropriate, to take decisions on the posture to be taken vis-a-vis the debtor country if developments are less favorable than planned. It would be expected, however, that banks and their advisors will treat staff reports in the confidential manner in which financial information provided by their clients is normally treated.

b. Length of Fund involvement

The issue also has been raised of whether the Fund should be committed to enhanced surveillance procedures for periods as long as those specified in the cases that have already received the attention of the Executive Board. In practice, the monitoring agreements between debtor countries and creditors in these cases have envisaged that enhanced surveillance by the Fund would extend throughout or well into the period of repayment of rescheduled maturities.

In principle, the period of Fund involvement should be influenced by the prospects for the recovery of the international financial system and for the normalization of the member's participation in that system. An initial commitment to a long period of Fund involvement raises questions about the expectations for the length of time needed to achieve normalization; indeed it raises doubts as to the exceptional nature of these procedures and could set a precedent for a role of the Fund in relations between a member country and its creditors which would be inappropriate on an ongoing basis. However, in these still

early stages of adjustment toward normalized market relations, persuading creditors to give up the leverage of yearly reschedulings requires that other assurances be provided. As was indicated earlier, commercial creditors would have preferred a continued, stronger form of Fund involvement. The length of time agreed for enhanced surveillance in these cases thus reflected discussions on a number of issues related to the modality of Fund involvement. As the twin concepts of multiyear reschedulings and enhanced surveillance take hold, it might be desirable, however, to scale back the length of Fund involvement.

By providing support for MYRAs in appropriate cases, acceptance by the Fund of enhanced surveillance for a member can, by signalling that a country's adjustment efforts are well advanced, promote the normalization of members' access to capital markets and, thus, international adjustment. It is not clear, however, that the Fund needs to remain as closely involved throughout the period of repayment of rescheduled maturities. In fact, it is the consolidation period over which normal access to international financial markets is expected to be re-established. The issue should thus be considered of whether the initial agreement by the Fund should not typically be for a shorter period, e.g., the consolidation period, or at most, a few years beyond the end of that period. A review by the Fund at the end of the period specified could be provided to determine whether sufficient progress has been achieved to re-establish normal surveillance procedures. Since the effective leverage of banks diminishes during the consolidation period of a rescheduling, depending in particular on whether the rescheduling is block or serial in nature, extending the initial agreement by the Fund to provide enhanced surveillance to a few years beyond the end of the consolidation period, perhaps through the grace period for some of the maturities, could help alleviate creditors' concerns. Such a period should also allow more than adequate time to achieve the needed improvement of debtor countries' policy formulation and implementation processes and of creditors' risk assessment procedures.

Clearly such shorter periods should not be adopted retroactively in those cases where the Fund has already agreed to a member's request. By agreeing to enhanced surveillance procedures in a specified period of time, and although it is not a direct participant to the rescheduling agreement between the debtor country and its creditors, the Fund knowingly gives an assurance to the debtor country on which creditors rely in making their decision to reschedule the member's debt.

The circumstances in which enhanced surveillance could be terminated at the end of the shorter period agreed initially would, of necessity, be limited. This course of action may be feasible only in cases of continued adequate adjustment. Terminating enhanced surveillance because of a failure by the member to maintain adequate policies would provide creditors with a clear "on/off" signal and, thus, would not be appropriate. In such cases, however, repeated negative appraisals in staff reports may already have resulted in activation of a review clause by

the banks or even a declaration of an event of default <sup>1/</sup> and, possibly, discussions between the Fund and the member for an arrangement for the use of Fund resources.

c. Leverage

The issue has also been raised of whether enhanced surveillance procedures provide sufficient leverage to the Fund in influencing members' policies. Clearly, the Fund's leverage under enhanced surveillance is substantially less than in the implementation of Fund policies for the conditional use of Fund resources. Since the Fund is not called on to endorse the member's policies as consistent with the criteria for use of Fund resources, the Fund's role is exercised primarily through appraisal and persuasion. The Fund's influence will be exercised in a manner similar to that in which this influence is exercised in the implementation of surveillance. Making available to commercial creditors the analysis and appraisal of the staff will intensify the efforts of the member's authorities to secure favorable assessments and should thus increase the weight of the Fund's assessments. Care, however, will have to be taken that the wider distribution does not result in a watering down of staff appraisals. In practice, it is quite possible that the leverage of the Fund may vary throughout the period of enhanced surveillance depending on the proximity of some kind of decision by the creditors, or if the latter's monitoring indicates a need for reassessing the basis of their agreement with the debtor country.

A related issue concerns the degree of the member's commitment to the policies outlined. Some Directors have suggested that a letter from the authorities, similar to a letter of intent in cases of use of Fund resources, would help clarify the policy intentions of the authorities. Such a letter would allow the authorities to present directly their objectives and the policies which they intend to implement to achieve these objectives, rather than through the reporting of the staff. However, it is not necessary for the authorities to explain their policies in this particular form; indeed, this form of expression is not used in Article IV consultations. Moreover, the risks inherent in the process should be clearly considered. Such a letter could be perceived as a commitment to the Fund, a commitment which the Fund neither needs in its role as analyst and advisor under enhanced surveillance procedures nor may be particularly keen to receive in cases where its advice is for the member to strengthen its policies, or to adopt different policies. Moreover, a "letter of intent" would inappropriately blur the distinction between the implementation of the Fund's responsibilities for the conditional use of its resources and the role of the Fund under enhanced surveillance. For these reasons, a letter from the authorities would not seem appropriate in the context of enhanced surveillance.

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<sup>1/</sup> Events of default refer to any event which allows creditor banks to declare the outstanding principal as well as all accrued interest due and payable on demand. Events of default in the agreements between Mexico, Venezuela, and Ecuador and their creditors are specified in the Annex.

5. The design of creditors' monitoring arrangements

Agreements between debtor countries and creditors in the early cases of multiyear rescheduling, both in those agreements finalized and those still in the negotiating stage, provide for several different forms of monitoring by creditors. Agreed or proposed monitoring procedures range from judgmental assessments of the sustainability of the debtor country's policies to the monitoring of certain variables in relation to agreed "trigger" values for these variables.

In principle, the design of trigger mechanisms and the establishment of monitoring procedures should be a matter for agreement between the debtor country and its creditors. However, early experience with MYRAs has raised several questions about the purpose and design of triggers and the role of the Fund, if any, in this process. Perhaps the primary role envisaged for triggers as one element of the monitoring procedures for MYRAs is to provide an "alarm bell" for both the creditor and the debtor. This could be helpful in alerting creditors and the authorities to a possible failure of adjustment policies or to the need for a redesign of policies. The function of triggers would be to initiate discussions between creditor banks and the debtor countries. With information from the most recent Fund staff report and other information provided by the country, creditor banks should be in a position to determine with the authorities whether the deviation was temporary or not.

There are several dangers in the use of triggers. There may be a temptation to see triggers as simple on/off switches for determining the appropriateness of continued restructuring or new lending. Such a simplistic use of triggers could create substantial difficulties. In particular, such mechanistic indicators cannot distinguish the reasons for a country's economic performance; a trigger can provide false signals--both positive and negative. A danger also exists that, with triggers in place, creditors may relax their more general monitoring procedures and focus less attention on the evaluations contained in the Article IV and supplemental consultation reports, possibly delaying substantive discussions with the country even if staff analysis and appraisals indicate the emergence of worrying trends.

There is also a danger that banks may want to abrogate their responsibility of indicating the necessity for adjustment to the country and shift that responsibility to the Fund. In such cases, banks may wish to introduce covenants into loan agreements which would call for discussions between the authorities and the Fund in the event a trigger is breached. Were discussions with the Fund initiated on the basis of the trigger, a presumption may be created that the Fund would provide a positive or negative signal regarding whether the deviation is temporary or a change in policy is called for, possibly even in the context of a Fund program. Such a procedure could draw the Fund into the creditor-debtor relationship in an inappropriate way, perhaps involving negotiation of a financial program outside the use of Fund resources.

In practice, the role that the Fund or the staff should play, if any, in establishing triggers should also be considered. To avoid charges that triggers represent a shadow Fund program and to assure a clear sense of proprietorship in these triggers on the part of the creditor banks, the Fund staff clearly should not negotiate the formulation or values of triggers for other parties. Nevertheless, the Fund staff could provide technical assistance.

#### IV. The Case of Colombia

##### 1. Nature of Fund involvement

The circumstances and modalities of Fund involvement proposed in the case of Colombia differ significantly from those examined in preceding sections. These differences relate, in particular, to the stage of adjustment, the financing required, and the nature of the judgment requested from the Fund.

Colombia is at an early stage of the resolution of its balance of payments difficulties. Typically, the participation of the Fund sought both by the member and its creditors in the early stages of adjustment has involved the use of Fund resources in support of the member's adjustment effort, and thus, Fund endorsement of the member's policies and Fund monitoring of progress in the implementation of those policies.

Endorsement by the Fund of a member's policies has generally taken the form of approval by the Fund of use of its regular resources. The Fund has approved arrangements for the use of its resources in a wide range of circumstances, including requests of a precautionary nature. <sup>1/</sup> In contrast, the procedures proposed in the case of Colombia separates the Fund's seal of approval from the use of its resources.

The circumstances of Colombia differed in two important respects from those of other members which entered into stand-by or extended arrangements with the Fund in the early stages of their adjustment process. First, the financing which sources other than the Fund were willing to commit to Colombia, albeit on a concerted rather than a spontaneous basis, was sufficient to close the external payments financing gap implied by the proposed adjustment policies. In principle, Fund

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<sup>1/</sup> Precautionary arrangements are those under which no actual use of Fund resources during the period of the arrangement is envisaged at the time of approval of the arrangement. In such cases, approval of the arrangement and monitoring of the program have provided members both a seal of approval, which may have been sought by the member either to support the domestic policymaking process or to facilitate relations with creditors, and an assurance of access to Fund resources during the period of the arrangement in case of unanticipated need.

involvement through approval of an arrangement, either precautionary or for a small amount, would have been appropriate. However, second and more important, the authorities of Colombia wished strongly to avoid at least some of the outward appearances of Fund involvement. Given the willingness of the Colombian authorities to adopt appropriate adjustment policies and the willingness of creditors to proceed, provided that an adequate substitute could be found which would include Fund endorsement of the member's policies and Fund monitoring of policy implementation and developments, insistence by the Fund on a formal arrangement could have delayed, and perhaps jeopardized, orderly adjustment by Colombia. Finally, a refusal by the Fund to respond flexibly to a member's request could have promoted perceptions of the Fund as an inflexible institution imposing preordained solutions on debtor countries.

The Fund is being asked to judge whether the policies proposed by Colombia are sufficiently strong and comprehensive "that Colombia would have qualified for access to the Fund's resources under an arrangement in the upper credit tranches." As is the case with programs supported by the use of Fund resources in the upper credit tranches, the policies which the authorities intend to follow are clearly identified in a letter from the authorities and an attached summary of economic policies. The Fund is to monitor the observance of performance criteria which it is asked to approve as providing appropriate yardsticks to assess the progress achieved in implementing the policies proposed by Colombia. Disbursements by banks over the 18-month period of their agreement with Colombia are linked to the observance of these criteria, with the understanding that small, self-correcting departures may be waived by the Executive Board, but with no provision for a modification of the program. Finally, consistent with practices in other cases when concerted lending is required to ensure that the financing gap is closed, commercial lenders must commit themselves to providing the required financing before endorsement by the Fund of the proposed policy program.

## 2. General issues raised by the case of Colombia

Several aspects of the arrangement proposed in the case of Colombia have elicited a favorable reaction on the part of some Executive Directors. One feature, in particular, that has commanded attention is the fact that a degree of Fund influence similar to that which the Fund exerts when it approves a financial arrangement can be achieved without use of Fund resources. Thus, without a commitment of its own funds, a mechanism has been found to encourage and support appropriate adjustment policies in a member country. In addition, this form of involvement by the Fund has helped mobilize financial resources from other creditors. This linking of outside resources to an endorsement by the Fund of a debtor country's policies is seen as providing additional leverage to the Fund's own resources in supporting effective adjustment by members.

At the same time, however, several Directors have raised questions about the more general applicability of the procedures envisaged under the proposed arrangement. For example, some Directors have questioned whether the procedures proposed in the case of Colombia presage a trend toward promoting, in substitution for use of Fund resources, a greater reliance on commercial sources of finance. The concern has been expressed that this could result in a diminution of the Fund's traditional role in supporting members' adjustment efforts through the commitment of its own financial resources. A formal procedure for Fund approval of a member's policies alternative to approval of an arrangement for the use of Fund resources could narrow the range of circumstances in which members would request the use of those resources. If it did, such requests could come to be perceived as a signal that other financing possibilities have been exhausted, an unfortunate association if the Fund is to remain useful to a wide range of members.

The question has also been raised as to whether a broader application of procedures similar to those proposed in the case of Colombia could result in commercial creditors requiring such Fund endorsement as a matter of course in a rapidly widening range of cases. Such efforts on the part of creditors to make the Fund a universal rating or monitoring agency could narrow the scope of normal spontaneous lending and could reduce the availability of capital for countries resisting creditors' pressures to enter into such arrangements. A move in this direction could also draw the Fund more deeply into debtor/creditor relations in inappropriate ways and in ways which hinder rather than foster a return to more normal operations in international banking and capital markets.

Questions have also been raised about the perceptions that may develop of Fund policies and guidelines when these are applied outside the context of the approval of use of its own resources. The responsibility of the Fund to approve use of its resources only when consistent with the provisions of the Articles provides an unquestionable basis for the application of its policies. The clear responsibility in that instance is to agree on an adjustment program with a member which promises a return to an external payments position that will permit timely repayment of the Fund's resources. When the Fund maintains a financial stake and thus remains a full participant in the financing decision, there is no doubt as to the standards that have been applied. In this connection, it may also be more difficult in the role of consultant to insist on the incorporation into programs of objectives which may not be shared as fully by commercial lenders; this could include, for example, measures for the promotion of exchange and trade systems free of restrictions. Thus, unless the Fund remains a full participant, both the perception of the standards for its policies as well as its ability to foster certain objectives for which it is given primary responsibility could eventually be weakened.

The case of Colombia also raises certain questions about the circumstances in which it is appropriate to resort to concerted lending. It is generally agreed that there was no viable alternative in this particular case. However, situations arise in which spontaneous lending by other creditors if combined with use of Fund resources is sufficient to fill an ex ante external financing gap. In these cases, foregoing the use of Fund resources by relying on concerted lending to elicit a somewhat larger flow of financing from other creditors would unnecessarily establish artificial and contrived relations between debtors and creditors. Such an approach could run counter to the restoration of normal financial market relations, and use of Fund resources would be the preferable alternative.

Finally, a request by a member for an arrangement for the use of Fund resources often intensifies domestic political pressures on the authorities, either or both as it is perceived as a formal recognition of a failure of past policies or as an imposition from outside of often difficult adjustment measures. In the case of Colombia, these pressures were considered to be such that an arrangement from the Fund would be counterproductive. Nevertheless, these pressures are not uncommon and the issue of whether uniform treatment of all members allows for special arrangements in certain cases needs to be carefully considered.

Directors may want to consider whether, for these or other reasons, it might not be better, where members are experiencing balance of payments difficulties, to continue to rely on arrangements for the use of Fund resources, including precautionary arrangements in cases when actual use of Fund resources is not thought to be needed. The key question in such cases would relate not to the best form of Fund involvement but to the level of access appropriate in the member's circumstances and consistent with Fund policies on access.

#### V. Summary

The main points dealt with in preceding sections may be summarized as follows.

1. *Progressing beyond the initial stages of the debt crisis* required that conditions be established which would lead to a restoration of normal relations between debtor countries and their creditors. An essential condition was that gross financing requirements return to levels that could be accommodated through a resumption of spontaneous lending relations. The cooperation of creditors in agreeing to MYRAs was essential to this process. Enhanced surveillance was conceived in that context as a means of facilitating the multiyear rescheduling of the "humps" in amortization payments by helping member countries provide to their creditors the information required to monitor economic performance. In the absence of such arrangements, the funding of scheduled debt repayments may have required continued concerted lending decisions by creditors and, possibly, associated requests for arrangements from the Fund.

2. Three separate elements together comprise enhanced surveillance: a quantified financial program, prepared by the country's authorities, presenting a comprehensive description of major macroeconomic objectives and the policies to be followed in their achievement; supplemental staff visits to the country concerned and supplemental staff reports and discussions of these reports by the Executive Board; and the release of staff reports by the member country to banks.

3. The focus of regular discussions with members on the formulation and implementation of objectives and policies against the background of a quantified financial program will help strengthen the ability of members to adopt and maintain policies consistent with financial stability. Such a focus of discussions could help extend the practice of more precisely quantifying policy objectives and instruments which is intended to be an important element of the more general process of improving the implementation of the Fund's surveillance responsibilities with all members. The release of staff reports to creditors in cases of enhanced surveillance should improve commercial creditors' risk assessment procedures by providing them the kind of information on the broad stance of the debtor country's economic policies needed to more effectively analyze credit risks.

4. While defining too precise a list of criteria for the Fund's willingness to support MYRAs by providing enhanced surveillance for a member may be premature, several considerations are clearly relevant. First, there should already be a strong record of adjustment to provide assurance that adequate policies are likely to be maintained. Second, sufficient progress in adjustment must already have been achieved to limit the member's need for net external financing to amounts that can, with confidence, be expected to be forthcoming spontaneously. Third, the member must be able to present a fully articulated and quantified policy program, the formulation and assessment of which will provide a basis to strengthen both the member's economic and financial programming and creditors' risk assessment procedures.

5. A fourth criterion, that enhanced surveillance should benefit the member and promote the normalization of market relations, raises several issues concerning the circumstances in which such procedures would be appropriate. These considerations suggest that enhanced surveillance should be limited to cases in which a multiyear rescheduling is necessary to normalize market relations and when the procedures of enhanced surveillance are essential to conclude that multiyear agreement. A widening of the range of application of enhanced surveillance could result in an inappropriate involvement of the Fund in the relation between debtor countries and creditors, retarding rather than promoting normal market relations; create risks that members may be pressured by their creditors into requesting enhanced surveillance; and delay rather than promote effective adjustment.

6. Enhanced surveillance has been conceived as an exceptional and temporary adaptation of Fund procedures and practices in response to equally exceptional circumstances. Unduly prolonging or widening the application of enhanced surveillance risks jeopardizing the confidential relationship of the Fund to its members. The success of enhanced surveillance for a limited period and the coincident strengthening of the Fund's traditional surveillance procedures should eliminate the need for these exceptional procedures.

7. The Executive Board should be provided an opportunity within a short time after management's decision to support the member's request to assess the appropriateness of enhanced surveillance in the member's circumstances and to decide on the member's request. The more frequent consideration by Directors in the application of enhanced surveillance of progress in the implementation of a member's policies will involve more active and continuous guidance, both of the member's objectives and policies and of the staff's review process. The issue was considered of whether not only staff reports but also Directors' views should be made available to commercial creditors. The risk was noted in this context that a broader circulation of Board views could increase the possibility of leaks, thus raising issues similar to some extent to those considered earlier by the Board in the context of publicity of Fund proceedings.

8. A full-fledged Article IV consultation should generally initiate the process of enhanced surveillance; the supplemental or midterm review should be focused on assessing the implementation of the program and the achievement of the member's objectives. Staff reports should make the empirical and analytical basis of policy judgments as explicit as possible, especially when staff views differ from those of the authorities. Staff reports provided to commercial banks should provide a frank assessment of policies and prospects in the member countries upon which the banks, together with other information received in their monitoring of economic developments in the country, can base their individual lending decisions on the collective decisions required under the multiyear refinancing agreements.

9. A commitment to enhanced surveillance for an excessively long period raises questions about both the expectations for the recovery of the international financial system and for the normalization of the member's participation in that system. It also has implications for the normalization of the Fund's relationship with the member. In the early cases of enhanced surveillance, however, agreeing to enhanced surveillance for a long enough period was part of the assurance needed for commercial creditors to agree to MYRAs. As the concepts of MYRAs and enhanced surveillance take hold, agreement by the Fund to enhanced surveillance for an initial period equivalent to the consolidation period or extending a few years beyond the end of that period should provide sufficient assurance to creditors. Such a period should also provide adequate time to strengthen the basis of debtors' borrowing

decisions and creditors' lending decisions. A review by the Fund at the end of this period could assess the need for a further extension of enhanced surveillance.

10. The design of monitoring procedures by creditors in MYRAs is a matter for agreement between the debtor country and its creditors. While the Fund staff should not negotiate the formulation or values of triggers, the Fund staff could provide technical assistance. Care will have to be taken, however, that this role not be seen as making the Fund responsible for observance of the triggers, for assessing the importance of a failure to observe the triggers, or for agreeing corrective actions with the member country.

11. Significantly different circumstances and modalities of Fund involvement are present in the case of Colombia. Members at an earlier stage of adjustment of their balance of payments difficulties typically have sought Fund support through approval of an arrangement for use of Fund resources. In the circumstances of Colombia, an alternative form of Fund involvement was sought. Several issues have been raised by Directors attendant on a wider application of procedures similar to those adopted in the case of Colombia. One feature which has commanded attention is the fact that a degree of Fund influence similar to that which the Fund exerts when it approves an arrangement can be achieved without use of Fund resources. Several questions have been raised, however, in particular whether these procedures could narrow the scope of spontaneous lending for members and of whether both the perception of the Fund standards for its policies as well as its ability to foster certain objectives for which it is given primary responsibility could eventually be weakened.

## Multiyear Restructuring Agreements

### I. Introduction

This annex reviews those aspects of the multiyear restructuring agreements with Mexico, Venezuela, and Ecuador relating to banks' and/or official creditors' monitoring procedures and the involvement of the Fund through enhanced surveillance. Section II reviews common features of the agreements and variations in the treatment of certain issues. Section III contains relevant material from the multiyear restructuring agreement between Mexico and its commercial bank creditors. Following a brief introduction, details of the restructuring agreement are included to clarify the commitment of the Fund in monitoring the economy, the content of the financial program to be prepared by the authorities under enhanced surveillance, the information the authorities will furnish to creditor banks, and the clauses containing covenants, events of default, and creditor voting arrangements in the event of an adverse change in the country's economic situation. Section IV provides similar background material relating to the multiyear restructuring of Venezuela's bank debt. Section V contains information on the arrangements for the multiyear restructurings of Ecuador's debt to commercial banks and to official creditors.

### II. Common Features and Issues

For the benefit of creditor banks, all the restructuring agreements signed to date set out in some detail the nature of Article IV consultation procedures and explain the contents of the reports prepared in connection with such consultations. The description of the Fund's role in monitoring continues with an outline of the content of midyear reports to be provided under enhanced surveillance. In discussing the annual and midyear reports, the language of the restructuring agreements makes clear that the appraisal provided by the Fund staff takes the form of an evaluation of the adequacy of the countries' policies, rather than an explicit judgment that policies meet a prescribed standard, such as upper credit tranche conditionality. Finally, the duration of enhanced surveillance is described. In this regard, the arrangements vary. For Mexico, enhanced surveillance will be conducted from 1986 through 1990 or 1994 (depending on the date of final repayment of Mexico's new money package). The Venezuelan enhanced surveillance will last through 1997 (the final amortization of the restructured debt). For Ecuador, enhanced surveillance begins in 1987 and is to continue until 1996 (the final amortization date of the restructured debt).

The content of the program which the country's authorities will establish is described, indicating the broad policy outlines and macro-economic objectives. An indication is also provided of the quantitative objectives which the authorities will set; in the case of Venezuela and Ecuador these are formally listed. A common feature is that the

quantitative objectives, where listed, are not described as performance criteria, to avoid confusion with ceilings negotiated with the Fund under an arrangement to use Fund resources. Also, the quarterly objectives are not fully specified at the outset. In the case of Venezuela, they are described as "covering" certain policy areas; in the case of Ecuador, they are referred to as examples--targets "such as the net domestic assets of the central bank, etc." Thus, an overly rigid specification of quantitative objectives for the future is avoided.

The agreements also specify the information to be provided to banks by the country's authorities, with particular reference to staff reports under the enhanced surveillance procedure by the Fund. The economic data to be provided directly to the banks, mainly on a quarterly or monthly basis, are also specified.

Finally, clauses in the agreements indicate what would happen in the event that the country's economic situation deteriorates, or other events of concern to the banks. Firstly, the covenants relevant to economic adjustment and the role of the Fund are set out. In each case, the country covenants that, if it is unable to meet its requirements for external resources through normal market channels, it will seek to cover the shortfall from noncommercial bank sources and it is explicitly stated or clearly implied that these sources may include the Fund. In the case of Ecuador, in the event of developments which would produce an external payments position inconsistent with continuing debt-service payments, Ecuador will request early consultation with the Fund and agree with the Fund on appropriate economic policy adjustments, possibly involving an arrangement for the use of Fund resources.

A key feature of each agreement is the provision governing whether, or to what degree, the restructuring is a "block" or a "serial" restructuring--that is, how strong a presumption is created that rescheduling of maturities falling due in the later years of the consolidation period will be dependent on satisfactory economic performance and policies. In this regard, the Venezuela agreement involves a four year-block rescheduling of future maturities; the Mexico agreement calls for debt to be rescheduled in two three-year blocks; and, in the case of Ecuador, a serial annual rescheduling has been agreed, dependent on Fund arrangements in 1985 and 1986 and on enhanced surveillance from 1987 (which, for official creditors, is also the last year of the consolidation period).

### III. Mexico

#### 1. Introduction

Enhanced surveillance is to follow the present extended arrangement (which expires at end-1985 and will continue through 1990 or 1994, depending upon the date of final repayment of Mexico's 1983 new money package). In the event that Mexico's economic situation or prospects

deteriorate such that it would be unable to meet its financing requirements through normal market channels, it has covenanted to seek financing from other sources, which may include a request to use Fund resources.

2. Role of the Fund in monitoring

Mexico will request from the Fund an enhancement of consultations as set forth below, in order to complement the country's own procedures to monitor economic performance and the implementation of economic and financial policies. The agreement also specifies that, in order to facilitate the enhanced consultations, Mexico and the Fund will exchange views on a continuing basis on all matters relevant to such consultations. The general coverage of staff reports is specified as follows.

a. Annual Article IV consultation report

In the context of Mexico's annual Article IV consultations, the Fund staff will review and appraise the objectives, policies, and projections contained in Mexico's Annual Operative Financial Program and Federal Budget for the forthcoming year, and will assess the country's economic and financial progress during the previous year. The Mexican authorities will provide all reasonable assistance and information required by the staff of the Fund to conduct this review. The Fund staff will include in its annual Article IV consultation report a summary of its discussions with Mexico on the country's financial and economic program, and its appraisal of that program. This report will also (i) comment specifically on whether the objectives and targets of the program are internally consistent, and (ii) address the compatibility of Mexico's financial and economic program (as set forth in its Annual Operative Financial Program and in the Federal Budget) with sound and sustained economic growth and with a viable external payments position consistent with the continuing servicing of debt. The report will cover specified areas of economic policy, objectives, and performance (see Section 3 below), and will further consider nonfinancial aspects such as relative prices, pricing policy, international trade policy, domestic and foreign investment, real GDP growth, employment, and other relevant policy areas which might have a bearing on overall economic performance.

In evaluating the performance of the Mexican economy, particular attention will be paid to the effect of the economic policies being pursued by the Mexican Government, changes in external developments which could affect economic performance, the evolution of the country's balance of payments, and the viability of Mexico's external payments position. The Fund staff will prepare its report for submission to the Executive Board within the time frame established by normal Fund procedures for such reports.

b. Midyear review

In addition to the annual Article IV consultation report, Mexico will request the Fund to conduct a midyear review of the performance of the Mexican economy; in this connection, the Fund staff will prepare a report based on its review. This report will address the progress achieved in the implementation of the financial program and the Federal Budget, measured against the targets established thereby. The reports to be prepared by the Fund staff after each six-month review will evaluate the performance of the Mexican economy on the same basis as that applicable to the annual review and will contain a description of the country's main economic developments, a summary of policy discussions with the Mexican authorities, and the conclusions reached by the Fund staff in its evaluation. The report will be submitted to the Executive Board of the Fund. With respect to purchases under the 1982 extended fund arrangement, the Fund will certify that Mexico has purchased all amounts scheduled to become available in 1985 under this arrangement.

c. Duration of enhanced surveillance

Monitoring procedures (including enhanced surveillance) will be implemented through the later of 1990 or the payment in full of the 1983 \$5 billion new money package.

3. Content of the annual programs

As currently required by Mexico's Planning Law and the National Development Program ("NDFP") approved in July of 1984, Mexico will prepare for 1985, and will continue to prepare for each fiscal year, a detailed and quantified Annual Operative Financial Program. Each such yearly program will contain a comprehensive description of the year's major macroeconomic policy objectives, targets, and assumptions, and will revise and update the short- and medium-term targets of the NDFP.

The Annual Operative Financial Program will include explicit assumptions about the behavior of key variables in the international economy affecting OECD member countries, and the United States in particular, such as growth, inflation, interest rates, trade flows, and oil prices. These assumptions will be based on the most authoritative forecasts available, including those of the OECD, BIS, IMF, and World Bank.

The program will include:

A. Broad policy outlines such as:

1. Fiscal policy
2. Credit policy, including financial intermediation by the public sector
3. Monetary policy
4. Exchange rate policy
5. Foreign debt policy

B. Broad macroeconomic objectives such as:

1. Inflation
2. Public and private savings
3. Public sector deficit
4. Current account balance
5. Non-oil exports
6. Imports
7. External debt

Beginning in 1985, existing procedures for the monitoring of the Mexican economy will be expanded to permit a closer appraisal of progress in implementing each yearly program. These monitoring procedures will be designed to facilitate prompt corrective action, should deviations arise. 1/ These procedures will include the close monitoring of developments respecting the overall public sector deficit, net credit expansion by the Banco de Mexico (in particular, as regards credit to the public sector), changes in the level of international reserves, and the balance of payments and growth of external debt.

4. Information to be furnished to  
creditor banks by the authorities

Mexico will furnish to the banks, within specified time periods, a copy of (i) the Annual Operative Financial Program (or equivalent document) and Federal Budget prepared by Mexico and delivered by Mexico to the Fund pursuant to the monitoring procedures; (ii) the annual and midyear consultation reports delivered by the Fund to Mexico pursuant to the monitoring procedures; (iii) a copy of the Letter of Intent and of the Fund report for the year 1985; 2/ (iv) quarterly reports containing data on the main aspects of economic objectives and management, the balance of payments, external debt, production, and medium-term projections; (v) reports on changes in main economic policy goals and projections, economic policy targets, Annual Operative Financial Program, Federal Budget, medium-term projections, and definitions of statistical series; and (vi) semiannual reports describing the progress in implementing the Mexican economic program and all amendments and modifications to such programs, along with annual projections of specified variables for a period of three years.

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1/ Existing mechanisms include quarterly reports to Congress on public finances and external debt and other periodic Government reports, including reports by the Banco de Mexico, the Ministry of Finance and Public Credit, and the Ministry of Planning and Budgeting.

2/ It is understood that such Fund report is for the last year under the extended Fund arrangement and will not be prepared pursuant to the monitoring procedures.

5. Covenants and events of default <sup>1/</sup>

a. Covenants

". . . if, as a result of material deterioration in Mexico's financial condition, Mexico is unable to meet its requirements for external resources through normal market channels, it will seek to cover the shortfall through nonbank sources such as the IBRD, the IDB, the IMF, and official bilateral sources."

b. Events of default

An event of default will occur if:

1. "The Majority Banks shall conclude that: (i) an amendment or modification of the Financing Principles distributed by the Borrower after the date of the 1985 Amendment is not acceptable to such Majority Banks; or (ii) there does not continue in effect substantial compliance by the international banking community to the satisfaction of such Majority Banks with the extension request contained in the communication dated December 17, 1984 from the Mexican Ministry of Finance and Public Credit to the international banking community and any further extension requests that may be made by the Mexican Ministry of Finance and Public Credit to the international banking community pending the implementation of the Financing Principles; or (iii) borrowers in the Mexican private sector do not have access to free markets for foreign exchange and the Mexican Government is not maintaining mechanisms to permit private sector borrowers access to foreign exchange at rates comparable to those generally available to the Mexican public sector."

2. "At any time after December 31, 1985 the Majority Banks shall conclude and notify the Agent that such Banks have determined in good faith that the Financing Principles have not been substantially implemented."

3. "The average level of the aggregate liabilities of the foreign agencies and branches of the Mexican Banks to non-Mexican commercial banks shall fall below US\$5,200,000,000 (or equivalent) during any calendar quarter occurring prior to December 31, 1986."

4. "The Majority Banks shall conclude and notify the Agent that such Banks have determined in their reasonable judgment, based on the comments and conclusions expressed in (x) the most recent annual IMF Consultation Report, or (y) the most recent midyear IMF Consultation Report, or (z) a combination of the most recent annual and most recent mid-year IMF Consultation Reports, which IMF Consultation Report(s) shall be identified in such notification(s) to the Agent, that (i) the

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<sup>1/</sup> The sections on covenants and events of default reproduce the text of the agreements.

implementation of the financial program of the United Mexican States is materially incompatible with sound and sustained economic growth of the United Mexican States and with a viable external payments position consistent with continuing debt service, and (ii) such incompatibility constitutes an Event of Default."

5. "The following events shall occur: (i) the Majority Banks shall conclude and notify the Agent that such Banks have determined in their reasonable judgment that the consultation and reporting procedures . . . are not being implemented as contemplated by the Monitoring Procedures within the time period set forth in any such Section with respect to the matters covered by any such Section; and the Agent shall notify the Borrower and the Banks of such determination . . .; and (ii) the Majority Banks shall conclude and notify the Agent that (a) the Majority Banks have determined that the failure to implement the Monitoring Procedures notified by the Agent to the Borrower and the Banks pursuant to clause (i) above remains unremedied to the satisfaction of such Majority Banks 60 calendar days after such notification by the Agent, and (b) the Majority Banks have determined in their reasonable judgment that such unremedied failure to implement the Monitoring Procedures constitutes an Event of Default."

c. Voting arrangements

The implementation of the second part of the restructuring (maturities due in 1988-90) will occur under the following conditions:

"Requisite Banks (defined as banks having more than 55 percent of the original commitments under the 1983 \$5 billion Credit Agreement) do not in their reasonable judgment determine (and give notice to the servicing banks between July 1, 1987 and December 1, 1987), based on the comments and conclusions expressed in the IMF annual or the 1987 midyear Article IV consultation report delivered pursuant to the Monitoring Procedures, that the implementation of Mexico's financial program is materially incompatible with the country's sound and sustained economic growth and with a viable external payments position consistent with continuing debt service. Banks having 33 percent of such commitments may trigger a bank vote on this issue."

"Requisite Banks do not determine in their reasonable judgment that the consultation and reporting procedures outlined in the Monitoring Procedures are not being implemented as contemplated thereby within time frames to be specified and with notice to Mexico and period for correction to be specified. Banks having 33 percent of such commitments may trigger a bank vote on this issue."

#### IV. Venezuela

##### 1. Introduction

The arrangements for monitoring Venezuela's economy closely parallel those adopted in the case of Mexico. However, Venezuela's initial adjustment effort was undertaken without a request to use Fund resources. The first staff report under enhanced surveillance was discussed by the Executive Board on May 30, 1985. Enhanced surveillance extends through 1997.

##### 2. Role of the Fund in monitoring

"Venezuela has traditionally consulted with various international agencies (such as Inter-American Development Bank, the World Bank, and the International Monetary Fund) regarding its economic programs, objectives, projections, and policies. The Government will continue these consultations and will provide information concerning the results of these consultations in its periodic reports to the creditor banks."

". . . Venezuela will request from the IMF an enhancement of these consultations as set forth below, in order to complement the country's own procedures to monitor economic performance and the implementation of economic and financial policies." "In order to facilitate the enhanced Article IV consultations, Venezuela and the Fund will exchange views on a continuing basis on all matters relevant to such consultations."

##### a. Annual Article IV consultation

In the context of Venezuela's consultations with international agencies (and, in particular, in the context of Venezuela's Article IV consultations), Venezuela will request the staffs of these agencies to review and appraise the economic objectives, policies, and projections of the Government contained in the annual program and in its National Budget for the forthcoming year. In the case of the Article IV consultation, this review also will assess the country's economic and financial progress during the previous year, with specific reference to the effects of the annual program for such year and the achievement of its quantified economic targets. The Venezuelan authorities will provide all reasonable assistance and information required by the staffs of these agencies to conduct these reviews.

Venezuela will request the Fund staff to include in its annual Article IV consultation report a summary of the discussions between Venezuela and the staff on the country's financial and economic program and the staff's appraisal of that program. Venezuela also will request the Fund staff to comment specifically in this report on whether the objectives and targets of the annual program are feasible and internally consistent, and are compatible with Venezuela's financial and economic program included in the Plan de la Nacion, and with a viable external payments position consistent with continuing debt service. This report

will cover the areas of economic policy objectives and performance mentioned earlier, as well as relative prices, pricing policy, international trade policy, domestic and foreign investment, real GDP growth, employment, and other relevant policy areas which might have a bearing on overall economic performance. In evaluating the performance of the Venezuelan economy, particular attention will be paid to the effect of economic policies being pursued by the Government, to changes in external developments which could affect economic performance, to the evolution of the country's balance of payments, and to the viability of Venezuela's external payments position. The Fund staff will prepare its annual report for submission to the Executive Board within the time frame established by normal Fund procedures for such reports.

b. Midyear review

To assist the Government with its monitoring process, Venezuela will request that the Fund staff make a midyear visit to Venezuela in each year, to conduct midyear consultations on the Venezuelan economy and to prepare a report based on these consultations. This report will address the progress achieved in the implementation of the annual program and the National Budget, measured against the targets established thereby. It will evaluate the performance of the Venezuelan economy essentially on the same basis as described above for the annual Article IV report and will contain a description of the country's main economic developments, a summary of the policy discussions with the Venezuelan authorities, and the conclusions reached by the Fund staff in its evaluation.

c. Duration of enhanced surveillance

The monitoring arrangements (including enhanced surveillance) will extend until the final amortization of the restructured debt in 1997.

3. Content of the program

Each annual program will contain a comprehensive description of major macroeconomic policies, objectives, plans, and assumptions; a statement of specific and quantified economic targets; and an update of the short- and medium-term fiscal, economic, and financial objectives of the "Plan de la Nacion" then in effect.

Each annual program will include explicit assumptions about the behavior of key variables in the international economy affecting OECD member countries, and the United States in particular, such as growth, inflation, interest rates, trade flows, and oil prices. These assumptions will be based on the most authoritative forecasts available, including those of the OECD, BIS, IMF, and World Bank.

The program will include:

- A. Broad economic policies such as:
  - 1. Fiscal policy
  - 2. Credit policy
  - 3. Monetary policy
  - 4. Exchange rate policy for all sectors of the economy
  - 5. Foreign debt policy
  
- B. Broad macroeconomic objectives such as:
  - 1. Growth of GDP
  - 2. Inflation
  - 3. Public sector results
  - 4. Current account balance
  - 5. Level of international reserves
  - 6. Exports (oil and non-oil)
  - 7. Imports
  - 8. Public and private sector external debt
  - 9. Capital outflows
  - 10. Public and private sector savings
  
- C. Specific and quantified targets covering:
  - 1. Level of domestic activity (percentage growth in non-oil GDP)
  - 2. Level of employment (unemployment rate)
  - 3. Average inflation rate (percentage change in the CPI)
  - 4. Monetary growth (percentage change in M2)
  - 5. Balance in current account
  - 6. Fiscal balance
  - 7. Total credit to decentralized public sector

Beginning in 1985, procedures established in the preceding year for the monitoring of the Venezuelan economy will be further expanded to permit a closer appraisal of progress in the implementation of each annual program. These monitoring procedures will be designed to facilitate current assessments of the program's effects, and to permit prompt corrective action should deviations from the program appear. These procedures will include the close monitoring of developments relating to the public sector results, net credit expansion by Banco Central de Venezuela (in particular, as regards credit to the public sector), changes in the level of international reserves and the balance of payments, and the growth of external debt.

- 4. Information to be furnished to banks by the authorities

The Government of Venezuela has prepared for 1985, and will prepare for 1986 and each succeeding year during the period of the restructuring, a detailed and quantified annual economic program.

In addition, the Government will provide the creditor banks with copies of the reports received by the Government from the international agencies as such reports become available, insofar as they relate to matters of appropriate concern to the creditor banks under the Restructuring Agreements. The reports to be provided shall, in all events, include the reports specifically referred to in the preceding paragraphs.

"(The) Republic and each other public sector borrower which is a party to a restructuring agreement (is) to furnish financial and other information, including in the case of the Republic (a) upon request after its completion, the then current Plan de la Nacion; (b) quarterly reports containing . . . (specified) information . . . and information concerning such Plan and updates of such Plan (the fourth quarterly report in each year also to contain Venezuela's Annual Economic Program for the following year, which will be prepared in accordance with the relevant provisions of the Republic's Economic Memorandum accompanying these restructuring principles); and (c) the reports referred to in the last paragraph of the Monitoring Procedures as they become available to the Government."

5. Covenants and events of default

a. Covenants

Covenants will include:

"Republic to complete the implementation of and to maintain the Monitoring Procedures . . . during the life of the restructuring; changes limiting the Monitoring Procedures to be mutually agreed by the overall majority banks and the Republic. . . . Republic to agree that if it is unable to meet its requirements for external resources through normal market channels, it will seek to cover the shortfall with funds and/or mechanisms (such as restructurings) from multilateral, bilateral, and other noncommercial bank sources."

b. Events of default

An event of default will occur if:

"The overall majority banks shall determine in their reasonable judgment (based on the information furnished pursuant to the Monitoring Procedures) that the results of Venezuela's economic program are or will be materially incompatible with a viable external payments position consistent with continuing debt service."

"Any event or condition (including, without limitation, any material adverse change in the economic or financial condition of the Republic or a public sector borrower) shall occur which gives reasonable grounds to conclude, in the reasonable judgment of the overall majority banks (in the case of the Republic) or the related public sector

borrower majority banks (in the case of a public sector borrower), that (a) the Republic will not, or will be unable to, perform in the normal course its payment obligations with respect to, in the case of the Republic, any of the restructuring agreements, including its guarantee thereof (in which case, an event of default shall occur under all of the restructuring agreements), or (b) such public sector borrower will not, or will not be able to, perform in the normal course its payment obligations under its restructuring agreement (in which case, an event of default shall occur under such restructuring agreement)."

Events of default also will include: "Operating reserves of Banco Central shall not be less than US\$2 billion; "Operating reserves" of Banco Central to be defined as reserves owned and controlled by Banco Central other than the following: (a) reserves held in the form of gold (valued at US\$300 per ounce); (b) Venezuela's net creditor position with the IMF, special drawing rights from the IMF, and other credit positions with the IMF; and (c) reserves held in any other nonliquid form."

"Failure to maintain membership in the IMF or eligibility to use the general resources of the IMF" would also constitute an event of default.

c. Voting arrangements

"Overall majority banks means, at any time, holders of at least 66 2/3 percent of the aggregate principal amount of the affected debt and restructured debt of all public sector borrowers then outstanding (but, in the case of affected debt, only such debt owed to holders which are parties to restructuring agreements)."

"Public sector borrower majority banks means, at any time, holders of at least 66 2/3 percent of the aggregate principal amount of the affected debt and restructured debt of a particular public sector borrower then outstanding (but, in the case of affected debt, only such debt owed to holders which are parties to such public sector borrower's restructuring agreement)".

V. Ecuador

1. Introduction

Ecuador is expected to be under stand-by arrangements through both 1985 and 1986. Enhanced surveillance would begin in 1987 and run for ten years, until the final amortization of the restructured debt. After 1986, the restructuring is "serial," insofar as there is explicit provision for banks to arrest the restructuring in any year if Ecuador's financial program is judged inadequate or if its external situation or prospects deteriorate.

As noted earlier, the case of Ecuador represents the first official MYRA in recent years and the first official debt rescheduling in recent years that was not strictly linked to the existence of an arrangement with the Fund in each of the years of the consolidation period. The Paris Club agreement also provides that debt relief in 1987 would be dependent either upon Ecuador having a Fund arrangement effective through December 1987 or upon specified enhanced surveillance procedures. Under the latter option, the rescheduling will become effective provided, inter alia, that the creditors have assessed positively that Ecuador has set forth in the process of consultation with the Fund, and is implementing, a comprehensive and satisfactory economic program for 1987, including quantitative quarterly targets.

2. Role of the Fund in monitoring

Ecuador will request from the Fund, for each year after 1986 during the term of the 1985-1989 Refinancing Agreement, an enhancement of consultations as set forth below, in order to complement the country's own procedures to monitor economic performance and the implementation of economic and financial policies. In order to facilitate the enhanced consultations, Ecuador and the Fund will exchange views on a continuing basis on all matters relevant to such consultations, including, in particular, the targets proposed in each program.

a. Annual Article IV consultation report

In the context of Ecuador's annual Article IV consultations, the Fund staff will review, appraise, and report on the objectives, policies, and projections contained in Ecuador's program and the Central Government Budget and the Monetary Program of the Central Bank each year after 1986 during the term of the 1985-1989 Refinancing Agreement, as well as the country's economic and financial progress during the previous year. The Ecuadoran authorities will provide all reasonable assistance and information required by the staff of the Fund to conduct this review. The Fund staff will include in each of its annual Article IV consultation reports a summary of the discussions on the country's financial and economic program and the staff's appraisal of that Program. Each report will also (i) indicate specifically whether the objectives and targets of the program are internally consistent; and (ii) contain an evaluation of the compatibility of Ecuador's financial and economic program with sound and sustained economic growth and with a viable external payments position consistent with continuing debt service. It is also specified that each report will evaluate economic policies, objectives and quantitative targets, and review actual performance, and will also cover areas such as relative prices, pricing policy, international trade policy, domestic and foreign investment, employment, and other relevant policy areas which might have a bearing on overall economic performance.

In evaluating the performance of the Ecuadoran economy, particular attention will be paid to the effect of the economic policies being

pursued by the Ecuadoran government, changes in external developments which could affect economic performance, the evolution of the country's balance of payments, and the viability of Ecuador's external payments position. The Fund staff is to prepare such annual reports for submission to the Fund's Executive Board within the time frame established by normal Fund procedures for annual Article IV consultation reports.

b. Midyear review

In addition to the annual Article IV consultation report, Ecuador will request the Fund to conduct a midyear review in each year after 1986 during the term of the 1985-1989 Refinancing Agreement of the performance of the Ecuadoran economy. Each staff report based on such reviews will evaluate the progress achieved in the implementation of the program, measured against the targets established thereby. The reports will contain a description of the country's main economic developments, a summary of the policy discussions with the Ecuadoran authorities, and the overall conclusions reached by the Fund staff.

c. Duration of enhanced surveillance

The monitoring arrangements (including enhanced surveillance) begin in 1987 and extend until the final amortization of the restructured debt in 1996.

3. Content of the program

As prescribed by present Ecuadoran law (including the Constitution of the Republic, the Ley Organica de Administracion Financiera y Control, the Ley de Regimen Monetario, the Ley del Consejo Nacional de Desarrollo, and other relevant Ecuadoran laws and regulations), the economic authorities of Ecuador prepare, and they will continue to prepare each year during the terms of the 1985-1989 Refinancing Agreement, a detailed economic program based on (a) the National Budget approved by Congress; (b) the Monetary Program of the Central Bank; and (c) the National Development Plan prepared by the Consejo Nacional de Desarrollo and approved by the President of the Republic.

As mandated by present Ecuadoran law and practice, Ecuador's annual program contains, and the Program for each year during the term of the 1985-1989 Refinancing Agreement will contain, a comprehensive description of Ecuador's major macroeconomic policy objectives, targets, and assumptions for such year, and will revise and update the short- and medium-term targets for the Republic.

The program's external sector projections will (as is customary) include explicit assumptions about the behavior of key international economic variables, including the level of interest rates in international financial markets and oil prices, and will take into account other relevant external growth and inflation factors. Ecuador will continue to use, for these assumptions, the most authoritative internationally accepted forecasts available.

The program will include:

- a. Broad policy outlines such as:
  1. Fiscal policy
  2. Monetary and credit policy
  3. Incomes policy
  4. Exchange rate policy
  5. Foreign debt policy
  6. Sectoral development policy (including petroleum and agriculture)
  7. Foreign investment policy
  
- b. Broad macroeconomic objectives such as:
  1. Inflation
  2. Real GDP growth
  3. Trade balance and its components
  4. Current account balance
  5. Overall balance of payments
  6. Public sector overall balance
  7. Domestic savings
  8. External debt
  
- c. Quarterly targets such as:
  1. Net domestic assets of the Central Bank
  2. Central Bank net credit to the public sector
  3. Net international reserves of the Central Bank
  4. Net disbursements of external debt

Ecuador will maintain in effect for each year during the term of the 1985-1989 Refinancing Agreement monitoring procedures permitting evaluation of progress in implementing each yearly program. Such procedures will be designed to maintain comparability and consistency in the figures over time, as well as to facilitate prompt corrective action should deviations arise. These procedures will be expanded where necessary to permit detailed reporting on program implementation and to facilitate after 1986 the enhanced consultation procedure outlined above.

4. Information to be furnished to creditor banks by the authorities

Commencing in 1987 and thereafter during the term of the 1985-1989 Refinancing Agreement, Ecuador will provide copies of the annual and midyear consultation reports prepared by the Fund staff to creditors (on the express understanding that such reports will be provided to creditors on a confidential basis). In addition, Ecuador will provide, on agreed dates, copies of its program and, periodically, copies of revisions or updates of the program. Copies of Article IV annual consultation reports for 1985 and 1986 are also to be provided.

5. Covenants and events of default

a. Covenants

"If Ecuador is unable to meet its requirements for external resources through normal market channels, it will seek to cover the shortfall through noncommercial bank sources, including the IMF, the IBRD, the IDB, and official bilateral sources."

"In the event of developments which could produce an external payments position inconsistent with continuing debt service payments, Ecuador will request early consultations with the IMF and agree with the IMF on appropriate economic policy adjustments (which may include a stand-by facility)."

b. Events of default

An event of default will occur if:

1. "The Majority Lenders will be able to declare an Event of Default under the 1985-1989 Refinancing Agreement if, in their reasonable judgment they determine, based on the comments and conclusions expressed in the IMF annual and midyear Article IV consultation reports, either that the implementation of Ecuador's economic and financial program is or would be materially incompatible with a viable external payments position consistent with continuing debt service or that there has been a deterioration in the financial or economic condition of Ecuador."

2. "In the event that the Majority Lenders determine in their reasonable judgment that the consultation and reporting procedures outlined above are not being implemented as contemplated hereby within the agreed time frames, the Majority Lenders shall so notify Ecuador; if the failure to implement these procedures is not corrected to the satisfaction of the Majority Lenders within an agreed time period, the Majority Lenders may determine that such failure constitutes an Event of Default."

c. Provisions reflecting the serial nature of restructuring

"The documentation for the refinancing of certain December 31, 1984 and 1985 through 1989 maturities of Ecuadoran public sector external debt (the "1985-1989 Refinancing Agreement") will contain, among others, the following additional conditions to the refinancing in each of 1987, 1988, and 1989 of covered maturities falling due in such year:

1. The Majority Lenders (holders of at least 51 percent of affected maturities) shall not have determined in their reasonable judgment that the consultation and reporting procedures outlined above are not being implemented as contemplated hereby within the agreed time frames;

2. The Lenders shall have received at least 45 days prior to the proposed refinancing date in each year the IMF annual consultation report evaluating the program for such year; and

3. The Majority Lenders shall not have determined in their reasonable judgment, based upon the comments and conclusions expressed in the IMF annual and midyear Article IV consultation reports, either that the implementation of Ecuador's financial and economic program is or would be materially incompatible with a viable external payments position consistent with continuing debt service or that there has been a deterioration in the financial or economic condition of Ecuador."

d. Voting arrangements

"Determinations by the Majority Lenders on the subject matters covered in items 1 and 3 above will be made as follows: a poll of the Lenders to elicit their views on a specified matter will be initiated by the Lenders' coordinating agent upon the instructions of holders of at least 33 1/3 percent of affected maturities, such instructions to be received by the coordinating agent within 45 days following delivery of the relevant IMF report; any proposed refinancing date will be deferred while such poll is being conducted; and any determination by the Majority Lenders must be made within 30 days after initiation by the coordinating agent of such poll."

6. Provisions of Paris Club MYRA

On April 24, 1985, Ecuador and its official creditors reached agreement on the rescheduling of maturities falling due over the three-year period through end-1987. The rescheduling agreement for Ecuador took the form of a conditional further rescheduling, i.e., the approach under which creditors agree at the initial meeting to provide rescheduling in more than one subsequent year, with the rescheduling to take effect automatically without a further meeting of creditors, provided certain conditions are met. In the case of Ecuador, while conditions were specified for the rescheduling for each of the years through 1987, only those conditions applicable to the third tranche in 1987 represent a deviation from normal Paris Club practices. Conditions for the first two tranches will require that Ecuador be granted an upper credit tranche arrangement for the Fund. A one-year stand-by arrangement for Ecuador through March 1986 had already been approved by the Fund Executive Board before the Paris Club meeting at which agreement was reached on this MYRA. Furthermore, the Ecuadoran authorities had indicated to their creditors their intention to seek a subsequent one-year stand-by arrangement when the existing one expires; and the second tranche of the rescheduling was made conditional, inter alia, on Ecuador having an upper credit tranche arrangement expiring no sooner than March 1987.

For the third tranche of the rescheduling, the Paris Club agreement stipulated that the provisions of the current MYRA Agreed Minute would apply from June 1, 1987 up to December 31, 1987, provided that the

Chairman of the Paris Club had notified the Government of Ecuador not later than May 31, 1987 of the positive assessment of the creditor countries on the fulfillment of certain specified conditions. In addition to those conditions normally found in other Paris Club agreements that provided for a further conditional rescheduling, the Agreed Minute for Ecuador included specifically the following conditions.

a. The Government of Ecuador either has an arrangement in the upper credit tranches with the Fund expiring not sooner than December 31, 1987, or has set forth in the process of consultation with the Fund, and is implementing, a comprehensive and satisfactory economic program including quantitative quarterly targets and limits, and covering the period up to December 31, 1987. In making their assessment, the participating creditor countries will have available both the staff report indicating whether Ecuador's program advances the adjustment effort implemented in the previous stand-by programs, and the Fund Managing Director's summary of the Board discussions.

b. The Government of Ecuador has secured, and will seek to secure from external creditors, effective rescheduling or refinancing arrangements on comparable terms in order to ensure comparable treatment.

If the assessment of the participating creditor countries is not positive, the provisions of the present Agreed Minute concerning the third tranche will not apply and a new meeting will be convened to reconsider the matter of Ecuador's debt-service payments falling due after May 31, 1987.

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