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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 85/45

10:00 a.m., March 20, 1985

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

Executive Directors	Alternate Executive Directors
A. Alfidja	W. B. Tshishimbi
C. H. Dallara	M. K. Bush
	H. G. Schneider
B. de Maulde	
M. Finaish	T. Alhaimus
H. Fujino	M. Sugita
G. Grosche	
	Jaafar A.
R. K. Joyce	L. Leonard
A. Kafka	H. A. Arias
H. Lundstrom	
E. I. M. Mtei	
	M. A. Weitz, Temporary
Y. A. Nimatallah	J. E. Suraisry
	G. Ortiz
J. J. Polak	J. de Beaufort Wijnholds
C. R. Rye	A. V. Romuáldez
	R. Msadek, Temporary
A. K. Sengupta	A. S. Jayawardena
	T. A. Clark
S. Zecchini	N. Coumbis
	Wang E.

L. Van Houtven, Secretary
B. J. Owen, Assistant

Also Present
N. Hope, IBRD. African Department: A. D. Ouattara, Director;
A. Baumgarten, R. O. Carstens, F. d'A. Collings, S. E. Cronquist, C. Enweze,
A. Jbili, E. K. Martey, J. C. Williams. Central Banking Department:
J. B. Zulu, Director; L. M. Koenig, Deputy Director. Exchange and Trade
Relations Department: C. D. Finch, Director; W. A. Beveridge, Deputy
Director; M. Guitián, Deputy Director; S. J. Anjaria, E. H. Brau,
J. T. Boorman, K. B. Dillon, L. J. Duran-Downing, K. Flug, G. R. Kincaid,
D. A. Lipton, M. Nowak, C. M. Watson. External Relations Department:
D. M. Cheney, H. P. G. Handy, H. O. Hartmann. Fiscal Affairs Department:
M. A. Mansoor. IMF Institute: O. B. Makalou. Legal Department:
G. P. Nicoletopoulos, Director; J. G. Evans, Jr., Deputy General Counsel;
R. C. Effros, Ph. Lachman, S. A. Silard. Research Department: W. C. Hood,
Economic Counsellor and Director; A. D. Crockett, Deputy Director;
R. R. Rhomberg, Deputy Director; J. Artus, D. J. Mathieson, P. J. Montiel,
M. C. Williamson. Secretary's Department: J. W. Lang, Jr., Deputy
Secretary. Bureau of Statistics: C. Briançon, P. L. Joyce,
J. B. McLenaghan. Personal Assistant to the Managing Director:
S. P. Collins. Advisors to Executive Directors: G. R. Castellanos,
L. K. Doe, P. Péterfalvy, T. Sirivedhin, A. Vasudevan. Assistants to
Executive Directors: H. Alaoui-Abdallaoui, J. R. N. Almeida, I. Angeloni,
W.-R. Bengs, J. Bulloch, M. B. Chatah, J. de la Herrán, J. J. Dreizzen,
G. Ercel, C. Flamant, R. Fox, V. Govindarajan, N. Haque, G. D. Hodgson,
A. R. Ismael, Z. b. Ismail, H. Kobayashi, M. Lundsager, J. A. K. Munthali,
K. Murakami, A. Mustafa, E. Olsen, J. K. Orleans-Lindsay, J. Reddy,
J. E. Rodríguez, C. A. Salinas, A. A. Scholten, L. Tornetta,
A. J. Tregilgas, B. D. White, A. Yasseri.

1. CAPE VERDE - 1984 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1984 Article IV consultation with Cape Verde (SM/85/67, 2/26/85). They also had before them a report on recent economic developments in Cape Verde (SM/85/82, 3/8/85).

The staff representative from the African Department noted that a difficulty had arisen with respect to the calculation of the real effective exchange rate for the Cape Verdean escudo. Recently, for the first time, the calculation had been made under the information notice system index, showing an appreciation of about 13.5 percent in the real effective exchange rate between the September 1982 discussion in the Executive Board of the 1982 Article IV consultation and January 1984. The calculations made by the mission, and included in the staff report for the present consultation, showed a real effective depreciation of about 13 percent over the slightly longer three-year period from 1982 to 1984 inclusive. The discrepancy was wholly explainable by differences in the weighting system and in the methodology; those differences would not normally be great, but, because of some rather unusual structural features in the external accounts of Cape Verde, the results did differ significantly. The staff intended to discuss again with the Cape Verdean authorities the appropriate methods of calculating real exchange rate movements and the implications for policies. The staff would urge that developments in the real effective exchange rate be kept under careful review in future.

The Chairman remarked that Executive Directors would no doubt wish to learn more about what had really been happening to the effective exchange rate.

Mr. Alfidja made the following statement:

> On balance, the economic and financial performance of Cape Verde has been satisfactory during the past three years. Output has expanded--though at lower rates in 1983-84--and inflationary pressures appear to have tilted toward abatement in 1984; credit expansion has been generally moderate, while no dramatic changes have occurred in the external sector. The overall outcome of government operations, however, has shown a slight deterioration in absolute terms but has remained unchanged or declined as a percentage of GDP.
>
> On available information, the investment-led growth of total output in 1982, when real GDP rose by nearly 15 percent, slowed markedly in the following year. The deceleration in real GDP to just under 6 percent in 1983 resulted largely from the effects of the completion of some major development projects, principally the Sal airport and the Mindelo shipyard. For 1984, indications are that the overall economic slowdown has

continued, with real GDP estimated to have advanced by less than 4 percent, partly on account of the effects of the perennial drought and the devastating floods of September 1984.

As indicated by the staff, the evolution of GDP in Cape Verde during the recent past has mirrored quite closely that of investment in major projects, all but one of which (the Mindelo shipyard) have thus far generated profits. This satisfactory financial performance of public enterprises reflected not only skillful management but also prudent selection of the projects in the first place, a selection based on such relevant and important considerations as the financial rate of return of the project, its net foreign exchange impact, its operating costs, the degree of concessionality of the financing and the need to ensure a balanced development of the various islands. The Cape Verdean authorities intend to continue to apply judiciously these and other criteria in selecting and implementing the investment projects. Where unforeseen circumstances create obstacles, they intend to show flexibility in addressing them--as evidenced by the decision to reduce considerably the number of foreign technical assistants formerly employed by the Mindelo shipyard and cut substantially the salaries and wages of Cape Verdean workers in order to reduce costs.

Fiscal policy in Cape Verde is principally guided by the need to ensure an effective balance between recurrent revenue and recurrent expenditure, to devote foreign aid resources to the financing of development outlays, and to make under normal circumstances only a minimal recourse to bank credit for budget deficit financing. The fiscal performance of Cape Verde during the past few years reflects adequately the application of these principles. The recurrent budgetary surplus reached C. V. Esc 73 million in 1983, up from C. V. Esc 32 million in 1982, thanks to a substantial expansion of revenue. This revenue growth encapsulates the impact of major changes in income tax laws and higher fiscal proceeds arising from the increase in services related to air traffic. As a result of a rise in foreign aid inflows in connection with the completion of the major development projects and the construction of road infrastructure in 1983, the overall fiscal deficit increased from C. V. Esc 1,009 million in 1982 to C. V. Esc 1,274 million in the following year. For 1984, the outturn of government operations appears to have deteriorated slightly owing to a smaller recurrent surplus. In that year, the combination of a slowdown in revenue (notably import duties) with increased spending on account of higher interest payments and wage bills led to a rise in the fiscal deficit to C. V. Esc 1,350 million. However, as a proportion of GDP, the deficit has decreased from 22 percent in both 1982 and 1983 to 19 percent in 1984. During the past three years, the fiscal deficit has been principally financed with foreign resources (proceeds from the sale of food aid and concessionary loans). The Government's recourse to bank credit--limited by law to 15 percent of the preceding year's revenue--was important only in 1983 because of the financing of the Sal airport project and the State's subscription to shares in the Mindelo project.

Monetary policy in Cape Verde rests chiefly on the pursuit of the objective of maintaining a strong foreign exchange position. Indeed, according to the Cape Verdean authorities, owing to the effects of factors such as the openness of the economy, the narrowness of the domestic market and resource base, and the limited number of real and financial assets, unrestrained monetary expansion is likely to be translated into increased aggregate demand, an undesirable erosion of the country's foreign exchange position, and stronger inflationary pressures. Therefore, credit expansion is adjusted judiciously in order to evolve toward this objective. Domestic credit rose moderately, by 12-14 percent, during the past three years, except in 1983, when the pace accelerated in order to accommodate some government borrowings. Reduced credit to the Government together with a slowdown in credit to the private sector was responsible for the slowdown in credit expansion in 1982. Credit to public enterprises for the purchase of equipment and the replenishment of working capital remained sustained over much of the period under review.

In the external sector, the dominant feature of the balance of payments is a low export/import ratio, the effects of which are normally compensated for by large inflows of workers' remittances and foreign aid. Cape Verde's current account position improved slightly in 1983, essentially thanks to a substantial increase in the balance of the services account arising from expanded bunkering activities, a reversal of the negative investment income flow recorded in 1982 on account of profit repatriation by a foreign oil company, and slightly higher inflows of remittances. Imports were virtually stagnant in 1983, whereas the downtrend in exports continued, largely reflecting the impact of the drought on production of bananas, Cape Verde's main export. On the whole, as a result of reduced inflows of official transfers and capital following the completion of some infrastructural projects, the overall balance of payments surplus narrowed from C. V. Esc 671 million (11 percent of GNP, 15 percent of GDP) in 1982 to C. V. Esc 285 million (4 percent and 5 percent, respectively) in the following year. On the basis of the available estimates, the dominant movement in the current account in 1984 was a small increase in imports, which combined with a marginal drop in private transfers to lead to a slight rise in the deficit. The deterioration occurred despite a reversal in the downtrend of exports and a small rise in net services. On the whole, the overall balance of payments was estimated to have worsened in 1984 as capital inflows were stagnant. Debt service has risen moderately during the past three years, reflecting mainly the expiry of the grace period of some loans. The country's foreign reserve position amounted annually to the equivalent of five or six months' imports during 1982-83. Indications are that this situation was preserved in 1984.

The progress achieved thus far in Cape Verde is all the more commendable considering the forbidding odds confronting the country, including a widely dispersed set of ten islands (the majority of which have no continental shelf to support low-cost fishing), a very uneven distribution of the population, and a lack of any known high-value mineral resource, sizable arable land, and suitable weather for cultivation. Faced with these difficulties and the responsibilities of nationhood, the Cape Verdean authorities have shown a keen and admirable sense of pragmatism and prudence. By way of illustration, in some other countries, food aid products are distributed free of charge; in Cape Verde, food assistance items are sold at prices closely reflecting world prices. Thanks to this policy, not only are financial resources collected, but the practice of price rationing and conservation is preserved. Moreover, instead of devoting the proceeds from the sale of the food products to financing higher current spending, the authorities apply these resources to financing development projects (wells and road construction). Another manifestation of the realism of the Cape Verdean authorities is their practice of formulating and implementing an overall credit policy that takes closely into account the country's large dependence on remittances and foreign aid--and, hence, its vulnerability to adverse movements in these flows. Cape Verdeans are not only pragmatic policy-makers but also skillful managers, as evidenced by the increasingly large transfers to the Treasury representing the Government's share in the profits of public enterprises. These and other policy initiatives bear witness to the high sense of responsibility of the Cape Verdean economic managers and their commitment to overcoming the formidable obstacles confronting the country. Cape Verde has received substantial assistance from foreign countries and international organizations as well. I am hopeful that the pragmatic policies and actions being initiated by the Government will continue to enjoy the firm and concrete financial and technical support of these countries and institutions in the years to come.

Mr. Mtei noted that the performance of the Cape Verdean economy in recent years had been impressive, with GDP growing by 7 percent per annum. Although domestic employment opportunities had remained meager, Cape Verdeans who had emigrated in pursuit of employment had been remitting large sums of money, which--together with considerable official aid inflows and concessional loans--had sustained investment in excess of 80 percent of GDP in recent years, thereby making possible an enormous development effort. Prudent and cautious fiscal and monetary policies had ensured price stability on the domestic front--imported inflation beyond the authorities' control having been fairly minor--and had also ensured an adequate buildup of reserves.

Cape Verde's limited natural resource endowment underscored the need for careful planning in its use, Mr. Mtei continued. The deployment of resources had been prudent so far, but he was concerned about the long-term sustainability of a situation in which domestic consumption exceeded 90 percent of GDP and the balance of payments relied heavily on external support. Under the circumstances, the authorities should focus all possible attention on obtaining more direct control of the domestic economy through long-term and comprehensive development.

In the past few years, poor weather had reduced domestic food production to only 10-20 percent of the country's food needs and, together with inadequate support policies, had also reduced the production of export crops such as coffee and bananas, Mr. Mtei noted. Perhaps the authorities should seek external assistance to raise output in the agricultural sector, which employed 40 percent of the population. In the industrial sector, the possibilities of establishing in 1985 large cement and salt manufacturing enterprises and of developing port facilities, with the collaboration of the African Development Bank, were encouraging. He asked whether Mr. Alfidja or the staff had any further information on those projects.

As for fiscal policy, the recent move to consolidate the ordinary and extraordinary budgets should facilitate better budgetary analysis and monitoring, Mr. Mtei remarked. So far, it was encouraging to note that the authorities continued to pursue cautious policies on the expenditure side, although on the revenue side, the tax system needed to be made more elastic, along the lines proposed by the staff; the need for external financing of the budget deficit would thereby be reduced in the long run. Credit had been controlled well, but there appeared to be a need to develop institutions for channeling credit to such sectors as agriculture, industry, and transport. Finally, the authorities should give further consideration to raising interest rates to positive real levels in order to foster the mobilization of funds and to attract higher remittances. He supported the proposed decision.

Ms. Bush observed that in spite of geographical constraints, unfavorable weather, and heavy dependence on foreign aid, Cape Verde had managed to maintain adequate real growth rates and a largely satisfactory balance of payments position. The authorities had tailored their development plans accordingly and appeared to be adapting well to changing circumstances.

Future economic growth of the country would depend heavily on the continued receipt of foreign aid on concessional terms and on heavy inflows of workers' remittances, Ms. Bush added. A continued large influx of foreign aid would depend to some extent on Cape Verde's ability to satisfy donors that the aid was being well used. In that respect, she hoped that the World Bank and Cape Verde would agree on future projects that would aid the development process. Furthermore, she urged the Government to be cautious in its investment strategy, given the decreased availability of concessional financing, the rising debt service burden, and the country's limited absorptive capacity. The encouraging steps taken to bring real interest rates toward positive levels should attract additional workers' remittances, which might otherwise be diverted to alternative investment. She urged the authorities to keep an active interest rate policy under consideration.

The commitment of the Cape Verdean authorities to improving the preparation of the ordinary and extraordinary budgets was gratifying, Ms. Bush commented. That improvement, in combination with the financing of recurrent expenditure through domestic revenue without recourse to domestic borrowing and the implementation of a cautious wage policy should promote financial stability.

To conclude, Ms. Bush noted, the medium-term debt scenario depended heavily on Cape Verde's obtaining adequate concessional aid. Therefore, the authorities were seeking to diversify the sources of that aid; she would be interested in further information in that respect. Finally, she was pleased to observe that the authorities were intent on pursuing a cautious borrowing policy in future.

The staff representative from the African Department observed that, in his judgment, the real effective exchange rate had probably been either neutral or depreciating: otherwise, it would be difficult to explain a 20 percent per annum rate of inflation over the past three years, a higher rate than would be expected from a normal increase in import costs. The staff had conjectured that at least a moderate depreciation of the effective rate was consistent with maintaining some pressure on import costs.

However, the staff representative explained, any precise calculation of effective exchange rates in Cape Verde was bound to be conjectural both because of the deficient data base and because of conceptual problems. A salient factor underlying the difference between the two staff calculations of the effective exchange rate was that the major currencies involved in Cape Verde's external transactions--the U.S. dollar and the Portuguese escudo--had been moving quite rapidly in opposite directions during the period under review. Under the circumstances, a small difference in weighting made a large difference in the results, and the weighting in the two calculations did differ. On the basis of its discussions with the authorities and its judgment of the relative importance of the major currencies, the staff mission had placed much greater weight on the movement of the dollar than was done in the calculations for the information notice system.

In terms of methodology, the staff mission had been looking primarily at the impact of the real effective exchange rate on inflation, the staff representative continued. For that reason, the rate quoted in the staff report had been expressed in terms of local currency, whereas the rate under the Fund's standard information notice system was expressed in foreign currency, based mainly on the concept of international competitiveness. On a comparable basis, the figure in the staff report would be a depreciation of 11.5 percent rather than 13 percent, compared with the 13.5 percent appreciation listed in the information notice. Finally, the unusual structure of Cape Verde's external accounts accentuated certain differences in methodology that would not lead to such a large discrepancy in the results in other countries. In particular, a substantial part of Cape Verde's external receipts came from countries that were former Portuguese colonies, for the most part in the form of emigrant remittances. Those countries were not included in the 36-country basket used in the Fund's information notice system. In the staff report, those receipts had been attributed to the dollar, which had therefore been given a much higher weight. The whole problem illustrated the uncertainties of real effective exchange rate calculations, which had to be interpreted with judgment, particularly in unusual cases such as Cape Verde's. At the same time, it was clear that the staff needed to discuss further the computations of the rate with the Cape Verdean authorities.

The construction of a cement plant, together with salt evaporation pans and associated road and harbor facilities on the island of Maio, was a project that seemed ready to move ahead, the staff representative noted. Financing on highly concessional terms had already been arranged: the African Development Bank had approved a loan of $28 million; the European Development Bank had agreed to a loan of $5 million; and additional funds were being provided by the Nigerian Trust Fund and by Belgian sources for equity in the project. The World Bank had recently declared itself satisfied, first, that the project would have a positive economic rate of return; second, that it would be a net earner of foreign exchange; and third, that it would not impose additional burdens on the budget or interfere in any way with other development projects. On those grounds, the World Bank had accepted that the project would be launched, and it intended to submit a proposal for an industrial line of credit to the Executive Directors of the World Bank in April 1985.

On the Cape Verdean authorities' attempt to diversify sources of aid, the staff representative noted that until about three or four years previously, heavy reliance had been placed on a few traditional sources of aid. However, in recent years, new aid donors had been successfully sought, including countries like Italy and Switzerland. Cape Verde had been able to diversify the sources of its aid partly because of its small requirements in terms of the donors' accounts, making it possible for them to give Cape Verde special treatment.

Mr. Alfidja said that his authorities in Cape Verde would be happy to discuss the question of the real effective exchange rate with the staff during the next consultation discussions. As for the Maio project, the explanation by the staff representative suggested that formal recognition should be given to the apparent status of the project, in view of the statement in the staff appraisal that in order to keep up the inflow of concessional foreign resources "...Cape Verde must continue to satisfy donors that the totality of aid is being well used, which makes it desirable that the authorities and the World Bank should reach a broad consensus of views over the proposed cement project."

The Chairman made the following summing up:

Directors expressed general agreement with the thrust of the staff appraisal. They noted with satisfaction that Cape Verde, despite geographical constraints, a very limited resource base, and prolonged drought, has maintained a strong balance of payments and reserve position during the past three years while also experiencing a high level of investment and positive real growth. Directors commended the authorities on the judicious use of large foreign aid flows in well-selected investment projects. Nevertheless, it was felt that the pace of investment and the associated large deficits in the overall budgetary and external current accounts might prove unsustainable over the longer run and had perhaps contributed to domestic demand pressure. Directors wished the authorities success in obtaining foreign support on favorable concessional terms for the forthcoming second National Development Plan, and expressed the hope that the World Bank would participate fully in the plan.

Domestic policies were seen as broadly appropriate under Cape Verde's circumstances. In particular, the authorities' determination to keep recurrent budgetary operations in balance, and to avoid undue monetary expansion, were welcomed. The authorities were encouraged to take steps to broaden and make the tax system more elastic. A policy of more flexibility in interest rates was urged for the future. Cape Verde's cautious foreign borrowing policy was welcomed. The authorities were also encouraged to pursue restrained wage policies.

The Board took note of the staff's remarks about the need to improve the quality and the availability of basic economic data in Cape Verde.

In view of the long delay since the previous consultation, it was agreed that the next Article IV consultation should be held strictly within the 18-month cycle.

The Executive Board then took the following decision:

1. The Fund takes this decision in concluding the 1984 Article XIV consultation with Cape Verde, in the light of the 1984 Article IV consultation with Cape Verde conducted under Decision No. 5392-(77/63), adopted April 29, 1977 ("Surveillance over Exchange Rate Policies").

2. Cape Verde's exchange system involves restrictions on payments and transfers for current international transactions as described in SM/85/67, which are, however, liberally administered. The Fund urges Cape Verde to simplify the exchange system and in particular to terminate the bilateral payments agreement with a Fund member as soon as possible.

Decision No. 7937-(85/45), adopted
March 20, 1985

2. DEVELOPING COUNTRIES' INDEBTEDNESS TO COMMERCIAL BANKS AND OFFICIAL CREDITORS; AND EXPORT CREDIT COVER POLICIES

The Executive Directors considered two staff papers, on developing countries' external indebtedness to commercial banks (SM/85/61, 2/20/85; and Sup. 1, 3/6/85) and to official creditors (SM/85/62, 2/20/85; and Sup. 1, 3/1/85), together with a staff paper on export credit cover policies and payments difficulties (SM/84/272, 12/18/84).

The Director of the Exchange and Trade Relations Department made the following statement:

> The three staff papers on developing countries' debt servicing difficulties focus on actions in both industrial and developing countries that would help to normalize relations between creditors and debtors and catalyze financial flows to developing countries, primarily from commercial banks and official sources.
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> Several recent staff papers have reviewed policies to foster economic conditions necessary to resolving developing countries' debt servicing difficulties. Executive Directors have already discussed certain aspects in their consideration of trade policy and developments, while they will address other aspects in their discussions on enhancing the effectiveness of surveillance by the Fund. The forthcoming discussion of the World Economic Outlook will provide Executive Directors with the opportunity to make major interventions on appropriate economic policies in industrial and developing countries to facilitate the resolution of current debt servicing difficulties. Therefore, in drawing together some themes arising in the three papers before the Board today, emphasis has been placed on financing issues. Executive Directors may find the framework suggested below helpful in structuring their remarks.
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> Considerable progress has been made in resolving developing countries' debt servicing difficulties since the widespread emergence of such difficulties in mid-1982. The systemic risks present at that time have receded but uneven progress has been made by the highly indebted countries in restoring a viable

payments position and in returning to sustainable real growth. Nevertheless, a basis has been laid in many of these countries for turning primary attention to the longer-run implications of their continuing high debt service burden for their prospects for durable growth, ability to attract renewed capital flows, and vulnerability to adverse external developments.

Policy actions therefore need to be consistent with ensuring that these countries regain access to sustainable financial flows. In this regard, the approach to resolving debt servicing difficulties that has been followed aims at a revival of financial flows at prudent levels, although such flows for individual countries may not be sufficient in the near term to finance sustainable growth or reflect the appropriateness of their adjustment policies. Executive Directors may wish to give their overall assessment of the present situation and prospects, and outline policy objectives for the period ahead.

Executive Directors may wish to discuss the conditions and actions needed to assure adequate financial flows to developing countries. The situation and prospects of individual highly indebted developing countries vary considerably. Consequently, appropriate actions by official and bank creditors, as well as by the debtor countries themselves, would also differ depending on the circumstances. While countries' problems require analysis on a case-by-case basis, a broad grouping of countries' situations and possible actions may facilitate discussion by Executive Directors. The role played by the World Bank in assisting developing countries to restore growth, to secure additional concessional financial flows, and to promote equity investment will be discussed by the Executive Directors of the World Bank.

a. For highly indebted countries that have made substantial progress in adjusting their economies, certain actions may speed a return to capital markets and sustain a recovery in economic growth.

Commercial banks could remove, where necessary, a "hump" in countries' future amortization payments that poses an obstacle to normalizing relationships between creditors and debtors by negotiating multiyear debt restructurings with extended maturities. They could also devise monitoring procedures that help ensure a proper balance between adjustment and financing during multiyear restructurings.

Where countries have demonstrated an ability to dispense with Fund resources, the Fund's surveillance can play an important role in fostering continuing adjustment. Moreover, to facilitate agreement on multiyear rescheduling arrangements with banks, certain member countries have proposed that, as part of creditors banks' monitoring procedures, the Fund undertake semiannual consultations ("enhanced surveillance") and that they be permitted to provide Fund consultation reports to their bank creditors. It is important that enhanced surveillance of a country's economy by the Fund not be seen by commercial banks as a signal that banks can relax their own monitoring. Banks would need to arrive at their own judgment about a country's current situation and prospects before making their independent lending decisions.

As countries continue to move away from the import compression phase of their adjustment efforts, the scope for action by governments and their agencies to stimulate financial flows will increase. There is a range of actions available to Governments to assist such countries in restoring more normal relations between creditors and debtors and, in particular, to foster normal trade financing. Governments could consider multiyear restructurings in order to help restore confidence in the country's ability to service new credits. Governments and their agencies could also employ their guarantee authority to facilitate new trade financing. These two approaches could be seen, to a certain extent, as complementary. On the other hand, there may be a direct tradeoff between restructuring and new export credit or extended cover; where such a tradeoff exists, a judgment is needed to determine, on a case-by-case basis, the technique most suitable to a country's circumstances and prospects.

Bank supervisors in major financial centers could continue their efforts to strengthen banks' balance sheets and to improve banks' assessment of risk. Such risk assessment needs to become more forward looking by appraising the impact on countries' policies. The effectiveness of banks' risk assessment will be a crucial factor in avoiding a return to past cycles of overlending and underlending to individual countries.

b. For countries still at an early stage in resolving their debt servicing difficulties, the approach followed has been shown to be effective in permitting orderly adjustment and laying the basis for economic growth.

Bank creditors appear to wish to maintain a link, on a year-to-year basis, between financial packages and adjustment programs supported by Fund arrangements. Financial flows to support a debtor country's adjustment policies should be determined on a case-by-case basis. Terms for such lending should be realistic while also facilitating the re-establishment of normal relations between debtors and creditors.

Official creditors could continue to show considerable flexibility in responding to the rescheduling needs of countries with debt servicing problems. To secure progress toward a lasting improvement in a debtor country's payments position, official creditors have required Fund members to have adjustment programs supported by an upper credit tranche arrangement.

Export credit agencies could pursue orderly and timely resumption of cover policies for debtor countries implementing adjustment policies successfully.

Authorities in major financial centers could continue to balance judiciously the need to strengthen banks' balance sheets against the possibility that too sharp a reaction by banks could be counterproductive and impair the value of existing claims; further concerted lending can be accommodated by permitting the gradual dilution of banks' exposure.

c. For countries that continue to experience protracted debt servicing difficulties, vigorous adjustment measures are required to redress the sources of their problems and to lead to an eventual restoration of durable growth. Financial support on appropriate terms is needed to support their adjustment efforts, with the use of Fund resources--when it is justified--largely limited to a catalytic role. The difficulties of low-income countries, especially in Africa, require special attention.

Bank creditors may need to adopt more flexibility in the financial terms provided to countries with protracted debt servicing problems. The severe nature of these problems implies that banks may wish to maintain a close link between their financial packages and the progress of a country's adjustment policies.

Official creditors have already exercised considerable flexibility in these cases by effectively rescheduling close to 100 percent of both principal and interest falling due. Consequently, there is little scope for further additional financing to such countries through debt relief. Any additional assistance to those countries implementing adjustment programs would need therefore to take the form of new bilateral or multilateral aid flows.

The continuing heavy debt service burden of many debtor countries renders the resolution of their debt servicing difficulties and return to sustainable growth vulnerable to adverse external developments.

As the impact on developing countries of adverse developments would vary, responses would need to be based on a country-by-country analysis of the situation and prospects. Such an analysis would permit adjustment policies to be designed so as to ensure that the additional financing required remains within the country's capacity to service over the medium term. Coordinated efforts by official and bank creditors would continue to require a link to a country's adjustment policies.

As in the past, debt restructuring by official and bank creditors, and concerted lending by bank creditors, where appropriate, would appear to be the most appropriate approach to securing additional financial flows.

Mr. Grosche observed that the number of highly indebted countries that had made substantial progress in adjusting their economies should increase in future; ways to support their return to capital markets appeared to be among the most interesting issues to be discussed at the forthcoming meetings of the Interim and Development Committees. One could not but agree with the staff that since 1982 the basis had been laid in many debt-ridden countries for turning attention to the longer-term implications of their continuing high debt service burden. The search must be for appropriate action to enhance the ability of countries to attract the renewed capital flows necessary for stable and sustained growth. Unfortunately, although the number of countries having made substantial adjustment progress was growing, it was not yet large. As in the past, countries' performances in dealing with their external indebtedness varied markedly. Yet all debtor countries were exposed to the same external environment, the same difficulties arising from uneven growth in industrialized countries, from trade barriers, and from high interest rates. There could be no doubt that the situation of all debtor countries had been aggravated by external constraints; industrialized countries would have to act decisively to ensure steady, noninflationary growth, low interest rates, and free access to markets. But there could also be no doubt that debtor countries would have to continue--and where necessary to intensify--their efforts to adjust their economies and re-establish their creditworthiness. The action to be taken had to be on the country level and shaped to the needs of each individual case; it had to be supported by official and bank creditors, again on a case-by-case basis. As the Director of the Exchange and Trade Relations Department had pointed out, coordinated efforts by official and bank creditors should continue to be linked to a country's adjustment policies and to its debt servicing capacity over the medium term.

Debtor countries should accord importance to attracting more nondebt-creating flows, Mr. Grosche considered. Piling up debt was often only a second-best solution to nondebt flows, direct investment in particular, which could provide not only new capital but at the same time products, markets, and technical skills.

Action by commercial banks had to strike a delicate balance between the need for banks to stay involved and the need to preserve a sound financial system, Mr. Grosche remarked. No one would gain if the financial system were impaired. Moreover, account had to be taken of the banks' need to strengthen their balance sheets. The removal of the "hump" in countries' future amortization payments by means of multiyear debt restructuring could indeed lead to a normalization of relationships between creditors and debtors, but the monitoring procedures to help ensure a proper balance between adjustment and financing would have to be devised by the banks themselves. Fund surveillance could play a role in that process, for instance, by holding semiannual consultations and by allowing debtor countries to make Article IV consultation reports available to banks for that special purpose. Nonetheless, the Fund's involvement should not mean that it would provide on/off signals about the appropriateness of further bank lending. The banks would have to arrive at their own judgment about the creditworthiness of a particular country. His own authorities maintained their view that they should not interfere with commercial decisions; on the other hand, they continued to make it clear to the banking industry that the banks would have to react flexibly in difficult cases. The advisory committees had been useful, and the banks would be well advised not to dissolve them too soon. A takeover of the monitoring function by the Institute of International Finance could be helpful, provided that all major banks involved decided to join the Institute.

Among the innovations in financial techniques mentioned on page 13 of SM/85/61, note issuance facilities, interest rate swaps, and other recent developments had indeed "increased the scope for nonbank borrowers to obtain funds on terms more favorable than those available to major banks," Mr. Grosche observed. Yet those innovations involved considerable risk: they would be available only in exceptional cases, and highly indebted countries at an early stage in resolving their debt problems would probably have no access to them at all. While there were as yet no indications that such innovations might seriously impair the strength of international banks, he was convinced of the need to keep a close watch on such developments and to analyze the possible repercussions on the stability of the banking system. Recent remarks by the Chairman of the Federal Reserve Bank of New York in that connection had been quite illuminating.

Bank supervisors would have to continue their efforts to strengthen bank balance sheets, Mr. Grosche commented. Many of the staff's helpful remarks seemed to be directed at the situation in the United States. In Germany, banks had already written off some loans and had made substantial provisions against lending risks; moreover, they had increased their capital/asset ratios by raising new capital. Recent adaptations of the law governing bank supervision would strengthen and enhance the efforts of German banks to improve their financial position.

He had noted the staff's concern about the risks inherent in banks' portfolios and its call for prudence, Mr. Grosche continued. However, the staff had rightly stressed the need to appraise the impact of debtor countries' adjustment policies so that banks could maintain and increase their exposure in the medium term while avoiding a return to past cycles of overlending and underlending. Admittedly, there were no easy answers to the question of how best to reconcile the two sides of an issue that pointed in different directions, but he was sure that the matter was worth discussing within the banking community and with banking supervisors. The Fund's contribution would also be appreciated.

With respect to the scope for action by governments and official agencies to stimulate financial flows to debtor countries, Mr. Grosche recalled that the governments of creditor countries had from the start played a crucial role in granting multilateral reschedulings and in stretching their cover policies as well as in maintaining aid flows despite budgetary constraints. As demonstrated by the sharp increase in the number of countries obtaining official debt reschedulings in the recent past, official creditors had made a major, useful contribution in overcoming debtors' problems by extending debt relief within the framework of the Paris Club. They had shown great flexibility with regard to terms and conditions on a case-by-case basis. The consolidation periods had been extended in some recent cases, successive reschedulings had been granted, and, occasionally, terms and conditions had been extended that could be considered exceptions to the normal Paris Club standards. As in the past, his authorities would assume their share of the burden in order to help the Paris Club maintain its important role.

On the issue of official multiyear rescheduling arrangements, Mr. Grosche recalled the declaration issued following the 1984 economic summit held in London, when the Group of Seven industrial countries had stated their basic readiness to respond flexibly, case by case, to countries' debt problems and to stand ready, where appropriate, to negotiate such arrangements in respect of debt to governments and government agencies. The question whether and under what circumstances official creditors might grant a multiyear rescheduling arrangement was under consideration within the Paris Club. One of the major issues involved was the linkage between multiyear rescheduling arrangements and Fund-supported adjustment programs. It had been standing practice in the Paris Club for such an adjustment program to be in place before an official rescheduling arrangement could be agreed. It had been suggested that a Fund program might not be necessary in the final phase of multiyear rescheduling arrangements; the question then would be how the Fund could contribute to ensuring an effective, ongoing adjustment effort. Those and other questions deserved further consideration, and proposals by the Fund would be welcome. Particular attention should be paid to the possibility that the provision of Fund advice in the absence of a firm stand-by arrangement might endanger the Fund's credibility.

He cautioned against putting official and bank multiyear rescheduling arrangements on the same footing, Mr. Grosche said. For banks, the arrangements were a temporary device pending their return to normal lending activities. For governments, such arrangements should remain exceptional; it was not normal practice for them to buy long-term claims at the expense of already severely constrained domestic budgets.

On whether governments could make more active use of their guarantee authority to facilitate new trade financing, Mr. Grosche went on, the debt difficulties experienced by many countries had already led to significant changes in cover policies. Greater flexibility and a case-by-case approach in response to particular circumstances had produced broadly satisfactory results; in principle, that approach should be continued. Given the need for a flexible response in individual cases, it was difficult to establish, at an international level, detailed rules and conditions for applying a common export credit cover policy. Moreover, it would be difficult to formulate such a common policy because of the particularities of individual agencies. However, his authorities welcomed the opportunity to exchange information on country exposure policies in general and on individual cases in particular; the OECD group on export credits could serve as an appropriate forum. He supported the suggestion that cover policies should not be discussed in the Paris Club, where however an attempt could be made to evaluate the results of rescheduling arrangements with a view to helping agencies decide on the provision of further export credit assistance to the countries in question. In that respect, a certain complementarity between reschedulings and cover policies, but no direct tradeoff, could be discerned--both approaches were quite different. He could not therefore detect any scope for a formal linkage between official multiyear rescheduling arrangements and export credit cover policies in the way described in SM/85/62.

A generally improved flow of information on export credit cover policies would help to strengthen the foundation for steady trade financing, financing that contributed importantly to the overall flow of resources, Mr. Grosche noted. Such information could include, for instance, making debtor countries aware of the general principles of creditors' export credit cover policies. As pointed out on page 30 of the staff paper on export credit cover policies (SM/84/272), an increased understanding of cover policies could help to avoid counterproductive or unwarranted action of the type taken by some debtor countries in the past.

He agreed with the staff that the approach followed in dealing with countries still at an early stage in resolving their debt servicing difficulties had proved its effectiveness, Mr. Grosche said. He had little to add to the staff's suggestions, and would stress only that financial flows to support a debtor country's adjustment policies should be determined on a case-by-case basis. He expected official lenders to show continued flexibility in rescheduling, provided that a Fund program had been put in place. He was somewhat concerned, however, about the willingness of banks to stay involved over a prolonged adjustment period, especially when smaller debtor countries were involved. The debtors and the Fund had a major task to convince banks to live up to their responsibilities, which stemmed in large part from their previous lending activities. Banks could be convinced more easily if credible programs could be devised and fully implemented.

As for countries continuing to experience protracted debt servicing difficulties, Mr. Grosche stated his full support for the staff views. However, in noting on page 20 of SM/85/62 that the flexibility shown by official creditors had resulted, in some exceptional cases, in a reduction of the actual debt service burden to a small fraction of scheduled obligations, so that there was virtually no scope for further financing through debt relief, the staff seemed to be expressing a note of regret, which was surely not intended.

Creditors should be commended for having granted that debt relief, although of course the need for further bilateral and multilateral aid flows should not be overlooked, Mr. Grosche noted. To conclude by citing the last words in SM/85/62, it was indeed unlikely, without a major reorientation of policies on the part of creditor countries, that "even a far-reaching restructuring of the service profile on existing debt would induce confidence in the country's ability to service any new credits." Restructuring of the service profile on existing debt would induce confidence in the country's ability to service any new credits.

Mr. Kafka observed that the picture given in SM/85/61 of the future flow of voluntary commercial bank lending was not encouraging, even though it might be too optimistic. The end--one might hope--of what might be called the sensational phase of the debt crisis was not a reason for complacency. There was some, but perhaps insufficient, emphasis in the staff paper on the part that regulatory authorities could play in encouraging prudent commercial bank lending, both directly and indirectly, to the extent that they could influence the attitude of external auditors and accountants. However, the staff paper underlined the responsibility that would have to fall in the future, more than in the past, on official bilateral and multilateral creditors, as well as the care that would have to be taken to keep the growth in indebtedness within countries' debt servicing capacity. In that connection, he emphasized not only the need for indebted countries to raise domestic savings but the useful role of private foreign equity investment.

As to the policy issues identified by the staff in Part V of SM/85/61, Mr. Kafka stated, the dependence of banks' attitudes on the economic situation of prospective borrowers could not be questioned, nor could the fact that the policies of both the borrowing and lending countries were determining elements, particularly the monetary and fiscal policy mix and the trade policies of lending countries. In fact, the medium-term scenarios for the world economy had concluded that the medium-term performance of indebted developing countries would be improved far more by better industrial-country policies than better developing-country policies. Whether the staff's confidence in the effectiveness of surveillance in that connection was justified would be a matter for separate discussion by the Executive Board. The main borrowers of course were already under the discipline of conditionality.

Multiyear reschedulings of debt to commercial lenders should be encouraged, Mr. Kafka considered, not only because they were generally associated with reduced spreads, fees, and charges--an important consideration--but because of the sheer waste of time involved in annual reschedulings. It was a loss of time for both banks and governments, although it was probably easier for banks to provide additional vice presidents when needed to handle debt reschedulings than for governments to dispense with finance ministers and central bank governors. In that connection, he fully endorsed the technique of enhanced surveillance, which could be applied somewhat more widely than it had so far. He also endorsed the staff's insistence that, even under enhanced surveillance, the Fund could not and should not give on/off signals to lenders. Neither should banks, if they were wise, be guided by the judgment of any other single institution. Monopoly of advice bred error.

He had found important the question raised regarding the manner of meeting the effects on borrowing countries of future adverse developments in the world economy, Mr. Kafka commented. Improved risk assessment by commercial banks would be a more helpful precautionary measure to them as well as to the indebted countries than mechanical rules on capital/asset ratios and provisions, although a gradual or general strengthening of banks' capital ratios was certainly desirable and had in fact already occurred. If there were a major deterioration in the world economic and financial situation, such a strengthening would not be sufficient.

Export credit cover policies were one of the most important aspects of maintaining and revitalizing the flow of credit to countries that had experienced debt servicing difficulties, Mr. Kafka considered. The staff had well summarized the causes of remaining on cover too long, namely, during the so-called build-up phase, but it had underrated the political pressures put on export credit agencies and the consequent inducements offered to borrowers to remain on cover. Countries in his constituency had had unfortunate experience of that kind in Eastern Europe. The consequences of the build-up phase were long lasting, and had a discouraging effect on the disposition of export credit agencies to maintain or resume cover. The legitimate objectives of avoiding a repetition of such consequences should not be allowed, however, to inhibit unduly the resumption and then the maintenance of cover. For countries experiencing debt service difficulties, there was now more willingness to maintain the flow of export credit and insurance, at least in the short term, but there was still too much insistence that a country in such difficulties ought to be able to make credible its intention not to reschedule short-term debt. Export credit agencies should be no less reluctant to assist rescheduling countries with new money, even when there was no strict analogy between such assistance and that granted by commercial banks to finance part of the interest payments that they themselves received. It was also regrettable that export credit agencies appeared to remain reluctant to pledge commitment targets, which at times could be helpful. However, he hoped that such agencies would increasingly take a flexible attitude not only on short-term but also on medium-term cover and guarantees.

The role of export credit agencies under conditions of increased risk perception would become more rather than less important in the recovery phase and in connection with the return to voluntary lending by commercial banks, Mr. Kafka added. Export credit agencies should not try to give up the practice of making individual and independent appraisals of investment projects in the context of investment programs. To hand over responsibility for appraisal to a single institution, even the World Bank, would saddle that institution with too much responsibility.

As for developing countries' indebtedness to official creditors, Mr. Kafka concluded, one major problem was the maintenance and indeed the increase of official development assistance, including contributions to multilateral financial development institutions. The other main problem to be stressed was that of multiyear rescheduling arrangements with official creditors. Like Mr. Grosche, he did not believe that greater flexibility in resuming export credit and guarantee cover policies was a proper alternative to official multiyear rescheduling arrangements. There was, however, no reason at all why official bilateral creditors should either eschew or insist on a rigid link between such rescheduling and the existence of a Fund arrangement in the upper credit tranches, especially when an enhanced surveillance scheme was in effect.

Mr. Joyce remarked that the emphasis in the staff papers on the fact that rescheduling was not a low-cost option and that there were tradeoffs between rescheduling terms and the attitude of creditors toward new credits was particularly welcome. The papers on export credit cover policies and on indebtedness to official creditors clearly set out the conditions under which governments were prepared to maintain financing, including short-term cover, even if a debtor country continued to experience debt service problems. In a number of recent cases, debtors might not always have fully understood the rules and practices of the Paris Club and of official credit agencies and might therefore not necessarily have acted in their own best interests. The staff papers and the Executive Board discussion might help countries to avoid some of those difficulties in future.

It was also helpful that the staff had attempted to clarify its own thinking on enhanced Article IV consultations, both in the paper on indebtedness to commercial creditors and in the paper prepared for the annual review of surveillance, Mr. Joyce continued. He looked forward to taking up various points in that respect on March 22. However, his authorities were disappointed that the paper on commercial bank debt did not deal more fully with a number of recent developments and innovations in bank lending, particularly to countries experiencing debt servicing problems. Insufficient credit was given to the work of the bank advisory committees and indeed to that of the key 20 or so banks in the world that had spearheaded efforts to overcome many technical problems and explored different methods of assembling new money packages and ensuring equitable burden-sharing among bank creditors. There could also have been more analysis of bank arrangements under which new funds were extended in the form of trade credits rather than purely financial credits, and especially more about the implications for a country's future debt servicing capacity of that type of lending and about the problem of allocating such trade credits within debtor countries.

Finally, the staff could have looked more closely at the new currency-switching options in certain recent reschedulings, Mr. Joyce considered. Such options were not without difficulty, even for debtor countries, especially those whose exports were denominated mainly in a particular currency. Those arrangements could also have important implications for exchange rates and interest rates in countries into whose currencies the loans might be switched. He asked the staff whether it expected any problems in that respect.

In retrospect, Mr. Joyce observed, there had clearly been a major evolution in the management of debt service problems over the past few years, with everyone becoming somewhat wiser. Commercial banks had shown resourcefulness in putting together a variety of arrangements--not without some creative prodding from the Fund--and in tailoring them to the needs of individual debtors. Those arrangements included the creation of bank advisory committees, the practice of concerted lending, multiyear rescheduling, currency conversion provisions, and cofinancing arrangements. Official creditors had also demonstrated greater flexibility than the debtors had given them credit for: they had expanded the range of debt rescheduling, offered more flexible terms, prevailed on official export credit agencies to maintain short-term cover, and extended exceptional financing when it seemed to be required. Of course, the enhanced role of the Fund in coordinating and catalyzing those arrangements could not go unnoticed. He did not wish to understate the lengthy and often difficult negotiations required to reach agreement on many rescheduling and new financing arrangements. Progress had been and was still being made. Without such a flexible approach, debtor countries would have faced even greater adjustment problems. And who could say whether the international system would have been able to tolerate the strain?

As the Director of the Exchange and Trade Relations Department had said, notwithstanding the substantial improvements made over the past two years, the debt situation remained finely balanced and would continue to require careful attention, Mr. Joyce agreed. Debtor countries needed to persist with their adjustment efforts not only to generate the necessary foreign exchange to meet their debt obligations but also to establish a sound basis for sustained growth in their economies, a basis established on increasing reliance on domestic sources of savings. For their part, industrial countries would need to implement noninflationary growth policies, to correct deeply imbedded structural rigidities, and maintain and liberalize the multilateral trading system. Otherwise, the efforts of debtor countries to implement, often at high social and political cost, the required export-led growth policies would be frustrated. Effective

Fund surveillance procedures could contribute to the process by encouraging sound domestic policies compatible with good overall performance of the international economy. Those issues were of course being discussed extensively by the Group of Ten, whose deliberations would, he hoped, yield concrete and productive results.

Different solutions would continue to be required for countries in differing circumstances, Mr. Joyce continued. He agreed with the staff that, for countries still at an early stage in dealing with debt service difficulties, the approach to be followed should be the one established over the past few years, with a clear, firm linkage between the provision of financial assistance and the adoption of adequate adjustment measures, and with the financing package underpinned by a Fund program in the upper credit tranches. Within that framework, creditors had already shown considerable flexibility, and he expected that they would continue to do so.

For countries that had made substantial progress in adjustment, it was appropriate to consider medium-term solutions to help them and their creditors return to lending on a more voluntary basis, Mr. Joyce remarked. Multiyear rescheduling was one such solution, although he would emphasize, like Mr. Grosche, that there was no reason to assume that official and commercial creditors both needed to participate in multiyear rescheduling arrangements or that, when they did so, the rescheduling terms should be identical. He also supported Mr. Grosche's view that it would be a mistake to assume that an extension of official export credit cover would automatically flow from the conclusion of a multiyear rescheduling arrangement. Likewise, he agreed with Mr. Grosche that important progress had been made in enhancing bank surveillance techniques and in bringing the banks to strengthen their financial positions.

Enhanced Article IV consultations were potentially another useful tool both to reinforce the member's commitment to longer-term adjustment efforts and to provide information to creditors so that they could make independent assessments of creditworthiness, Mr. Joyce stated. The Fund should of course avoid giving stop-go signals to the banks or to other creditors. Other financial institutions should make their own risk assessments, do their own monitoring, and govern themselves accordingly. As the staff had pointed out, the Fund would remain an important source of information; how important would depend on the outcome of the Executive Board's consideration of enhanced surveillance and the understandings that might be reached on the release of information. In that context, if debtor countries wanted to receive continued financing, they should go on providing, at their own initiative, as much information as they could on the progress of their economies.

The World Bank could play a useful role in providing more information, based on its analysis of the medium-term prospects for individual countries and for particular sectors in their economies, as noted in the staff paper, Mr. Joyce said. The Fund was continuing to benefit from the World Bank's assessment of investment plans and sectoral policies, and official creditors and commercial banks themselves would surely look increasingly to the World Bank for advice and guidance.

He saw no viable alternative to dealing with debt problems on a case-by-case basis, because it provided the maximum flexibility to both creditors and debtors, Mr. Joyce considered. So-called global debt relief measures might interest academics, but they would not encourage an earlier return to voluntary lending or pave the way for sustained growth, either in world trade or in member countries' economies. The countries that would be most penalized would be those that had already taken significant adjustment measures and had reached the threshold of recovery and renewed lending. In his view, concerted lending--for all its flaws--was still preferable to mechanisms such as interest rate capping, which would serve only to discourage further the return to lending on a more normal basis.

In conclusion, Mr. Joyce remarked, many developing countries had made progress in improving their debt service position in the past few years, but careful management was still required. The Fund's role in fostering adjustment and in carrying out surveillance remained essential. It might be found necessary to re-examine the Fund's relationships with bankers and official creditors; some of the more recent practices had been forged in exceptional circumstances; before they were institutionalized for the longer term, they would have to be reconsidered carefully.

Mr. Rye noted that since the debt problem affected all alike--either debtor countries and creditors, or neither, all being members of the world economic community--it was important to establish a measure of consensus on the causes of that problem, and, more important, the solutions to it. The staff's analysis of the source of the debt problem could be summarized under three broad headings. First, debtor countries had followed inappropriate macroeconomic and structural development policies, including excessively expansionary fiscal policies, overambitious investment programs, and government-induced distortions in prices, including interest rates and exchange rates. Second, debt management had been feeble, both by debtors, which had paid insufficient attention to maturity structures, debt servicing implications, and the need for reserve cover, and by creditor banks, which had failed properly to monitor--or even to understand--international developments and associated risks. Third, there had been unfavorable "exogenous" developments, beginning with the two oil shocks, leading to depressed prices for primary commodities, prolonged recession and increased protectionism in industrial countries, and sharply increased interest rates; some of those developments were a legacy of delayed and inadequate adjustment by industrial countries themselves.

Debate on the subject often tended to focus in a sterile way on how to apportion the blame among those causes, particularly between inappropriate policies at home and unfavorable developments abroad, Mr. Rye observed. It was enough to acknowledge that all three had contributed to the current situation in which a number of developing countries had large debt burdens, some of which were not serviceable on the terms originally negotiated. Clearly, however, ongoing economic adjustment would be essential to a medium-term easing, and eventual resolution, of the debt problem. In that respect, the approach adopted by the Fund, as well as by official and bank creditors, of tying financing to adjustment programs was essential. He also supported the case-by-case approach to achieving, for each debtor, an appropriate mix of economic adjustment and financing. That approach recognized the differing circumstances confronting each country as well as the importance of getting both creditors and debtors to focus on specific arrangements, thereby lessening the risk that adjustment and financing endeavors would be dissipated, as they might be through more generalized relief operations. Of course, the heavy demands that adjustment and debt servicing burdens were placing on some countries could not be ignored; there was a need for realism in framing adjustment programs and financing packages.

From that pragmatic standpoint, it had been heartening to observe the way in which new institutional arrangements, such as the Paris Club, had either emerged or evolved in response to the need for coordination and dialogue, Mr. Rye went on. A reasonable balance had been reached between the interests of debtors and creditors that recognized the mutuality of those interests. However, some aspects of those arrangements called for comments. First, care needed to be exercised in grouping debtors into categories, not only because of the need to analyze countries' debt problems case by case but also because, for many countries, the situation remained fluid. Moreover, even though the systemic risks present in 1982 might have receded, it was much too early to say that they had disappeared. In turning primary attention to the longer-run concerns of countries that had already made considerable progress in resolving their debt servicing difficulties, care had to be taken to ensure against slippages that could convert long-run problems back into short-run crises.

Second, while his chair supported enhanced Fund surveillance of economies as a means of assisting debtors in their relations with commercial banks, Mr. Rye noted, it was important that the assumption by the Fund of such a role should not be seen by commercial banks as a signal to relax their own monitoring. As a result of its active catalytic role in averting a debt crisis to date, the Fund had already put its credibility on the line, at some potential risk to its own future effectiveness. Although it would be difficult to cavil with what had been done to date--on the contrary, it deserved full support--his own authorities remained concerned that the Fund should not enmesh itself too closely in relationships between banks and debtors. He therefore fully endorsed the need for continued efforts by banks to improve their own risk assessment of countries and their policies.

Third, official debt rescheduling had exhibited considerable flexibility in meeting debtors' needs; overall, the Paris Club procedures seemed to have worked well, Mr. Rye commented. He welcomed the suggested further development of those procedures to accommodate multiyear restructurings. It was necessary however to ensure that such a development did not lead to any erosion of the principle that rescheduling should be tied to adjustment. Accordingly, of the two approaches described in Part V of SM/85/62, he favored the goodwill clause because the existing requirement that a program supported by an upper credit tranche arrangement with the Fund be in place would be retained. One possible question was whether the

Fund itself was sufficiently well informed of Paris Club practices and procedures. The authorities of some of the countries that had elected him harbored doubts on that point, and he would welcome staff comment. Certainly, there should be close--and perhaps more regular--communication between the Fund and the Paris Club. The Fund might also be able to assist in improving the timeliness and distribution of data through an expansion of its surveillance role.

There might be some advantage to creditors and debtors from a codification of principles or guidelines underlying negotiations, Mr. Rye added, provided that such a codification did not reduce the flexibility of the present case-by-case approach. Any move to increase the information available to the parties involved would be of benefit; in that vein, he would support any attempt to establish more objective listings of the official agencies that were, or should be, included under the umbrella of official rescheduling.

Fourth, there were welcome indications in SM/84/272 that export credit agencies were becoming more aware of their possible role and responsibilities in assisting debtor countries to achieve a more normal debtor status, Mr. Rye noted. It was particularly welcome that the agencies were showing an increased appreciation that strict adherence to their past policies might lead them to restrict export credit to an unduly narrow range of export markets. What was not clear from the staff paper was just how adequate the response of those agencies had been so far, and how much more adaptation was required. On the face of things, there still seemed to be room for improvement. Thus, according to the staff paper, most export credit agencies felt that, with respect to trade financing, "case-by-case international arrangements should not be conceived as an integral part of a financing package to fill a financing gap..."; he hoped, however, that arrangements would evolve under which the agencies would participate fully in the rescheduling process at an early stage and, where appropriate, contribute to the package as a whole. It would be important to develop a closer relationship between debtor countries and the agencies providing them with greater access to export cover. In that respect, it appeared from the staff paper that debtor countries might have inadequate knowledge of the export credit agencies' preferred approach for cover restoration and maintenance. If so, the agencies themselves should take the responsibility for improving debtor countries' awareness of the ground rules. To go somewhat further, the authorities of one of the countries in his constituency suggested that there should be some mechanism to ensure that, upon the signing of Agreed Minutes of the Paris Club, export cover to the relevant country was resumed.

Finally, the issues raised by the problems of low-income countries and, in particular, those of countries continuing to experience protracted debt servicing difficulties, seemed to be far from resolved, Mr. Rye said. Many of the countries of sub-Saharan Africa in particular had made only limited or no progress in dealing with their debt problems, let alone in restoring growth in per capita incomes. Some of the fundamental issues that that limited progress raised for the Fund were already presenting themselves in the form of prolonged use of Fund resources and, increasingly, overdue obligations to the Fund. Those problems raised questions about the nature of the Fund's role in such countries. The stage already had been reached or, if not, soon would be, where the Fund would be faced with a fundamental choice. Either it could further strengthen its analysis of medium-term structural adjustment issues, and adopt policies and arrangements better suited to achieving adjustment in low-income developing countries, or it could withdraw from its present involvement with the structural problems of such countries and concentrate on its original charter as a monetary institution dealing with temporary balance of payments problems. The more he saw of the problem, the more he leaned toward the latter course, for the sake of preserving the Fund's unique and valuable role in the world financing system. With that in mind, he would underline the comment in the opening statement by the Director of the Exchange and Trade Relations Department that "financial support on appropriate terms is needed to support...adjustment efforts, with the use of Fund resources--when it is justified--largely limited to a catalytic role." That comment was particularly true of low-income countries in Africa.

Mr. Alfidja referred first to the main features of present rescheduling arrangements, as described in SM/85/62 and Supplement 1, in which the staff had provided an excellent summary of the principal features of reschedulings under the aegis of the Paris Club. Furthermore, the glossary of terminology in Part 2 of Supplement 1 had been particularly useful; a similar presentation in other staff papers prepared for the Executive Board, especially those treating technical and infrequently discussed topics, would be most welcome.

According to the staff, the general principle was to limit the coverage of debt to be rescheduled to current medium-term and long-term maturities, Mr. Alfidja continued. Short-term maturities, payments arrears, previously rescheduled debt, and some government-guaranteed debts were excluded from the stock of debt to be rescheduled; in some instances, even interest payments were excluded. There had been only two exceptions to that rule before 1983, both relating to previously rescheduled debt. During 1983 and 1984, however, the instances of rescheduling of payments arrears and of previously rescheduled debt had risen to four and five, respectively. It would be of interest to know how many requests had been made for rescheduling short-term maturities, payments arrears, and previously rescheduled debt that had not been favorably acted upon. In any event, he shared the staff's conclusion that the increase in the number of reschedulings of payments arrears and previously rescheduled debt between 1983 and 1984 bore testament to the increasing acuteness of the debt problem. The effective impact of debt rescheduling was certainly weakened by the effects of those limitations on coverage.

On the consolidation period, Mr. Alfidja considered, countries requesting debt relief could not formulate and implement financial plans adequately if the rescheduling period remained constrained to 12-14 months, as was generally the case. Multiyear rescheduling made more sense if available scarce resources were to be programmed and used efficiently. Annual rescheduling agreements not only left unresolved the problem of uncertain future streams of financial flows but was also costly. Another highly unsatisfactory feature of debt consolidation was the exorbitant interest and other charges applied to debt service. Unless those additional costs were eliminated or drastically reduced, little or no benefit could be derived from temporary debt relief because its financial impact could well be offset by outflows for servicing such interest payments and charges.

A crisis of confidence in the strength of the international financial system had been averted thanks in part to the rescheduling agreements reached in the different groups of creditors, Mr. Alfidja remarked. Trade and payment flows had been maintained. His chair could not but express its satisfaction with those developments. However, that success should not be allowed to obscure the fragility of the international monetary system. It was the firm and unanimous view of the authorities of the countries of his constituency that debt rescheduling was anything but a durable and effective solution to the debt problem. They shared the opinion that the structural imbalances characterizing not only the economies of debtor countries but also several components of the international economic and financial environment would have to be forcefully and successfully tackled in order to resolve the external debt problem.

Among the considerations to be borne in mind in the search for solutions, Mr. Alfidja commented, in the short run, the principal features of the present debt rescheduling framework needed to be considerably improved. Special emphasis should be placed on reducing the financial costs of such operations and on expanding their coverage. Looking further ahead, it was of paramount importance that debtor countries should undertake a multifaceted adjustment program aimed at establishing a strong pace for sustained economic growth and a viable external position. The implementation of a disciplined fiscal and monetary policy could prove crucial in achieving those objectives. That domestic effort, if it were to succeed, would need to be supported by fresh inflows of financial resources.

Many of the observations that he had made already applied also to commercial bank debt, Mr. Alfidja noted. In particular, the cost of rescheduled commercial bank debt must be reduced significantly. Furthermore, in support of the adjustment effort under way in many developing countries, commercial banks ought to provide adequate fresh money; they must maintain if not increase their exposure. The resources should be made available to all countries, including those whose difficult debt servicing problem was not necessarily perceived to be a threat to the international financial system. He had in mind the low-income, medium-sized and small developing countries, especially those in Africa, to which brief reference had been made in the opening statement by the Director of the Exchange and Trade Relations Department. With respect to the role of the Fund vis-à-vis those countries and possible ways of resolving their problems, he had no choice but to strongly disagree with Mr. Rye's comments.

Of course, his disagreement did not relate to Mr. Rye's statement on the seriousness of the problems facing debt-burdened developing countries and the need for an in-depth study of the nature and characteristics of the problems, but rather with his inclination to exclude part of the Fund's membership from using the resources of the institution on the grounds that the countries in question were experiencing structural problems and had had repeated access to the Fund's resources.

It was also important that private companies providing suppliers' credit continue to offer such financing, Mr. Alfidja remarked. Those flows were obviously beneficial not only to the developing countries but also to the industrial countries as they helped, inter alia, to maintain employment and GDP at higher levels than would otherwise be the case. His authorities also shared the view that developed nations should adopt policies leading to an increase in financial flows to debtor countries and a decrease of unwarranted flows out of those countries. More specifically, developed countries should open up their markets to the exports of developing countries, act to improve the latter's terms of trade, and implement policies leading to lower interest rates.

To conclude, Mr. Alfidja observed, the Fund under the leadership of the Managing Director had played an important, sometimes crucial role in the debt field. It had been a major catalyst in the conclusion of several rescheduling arrangements. However, as his chair had stated during the seminar on external debt restructuring held in 1983, the Fund should draw the attention of creditors to the effect of additional charges and interest on overburdened countries. It should be forcefully stated that such practices were counterproductive; somehow, ways must be found to drive that point home to creditors.

Mr. Fujino said that he had been pleased to note that the combined efforts of the indebted countries and official and private creditors, in cooperation with the Fund and other international institutions, had contributed to the marked improvement of the world's financial difficulties. The impressive turnaround had been helped by strong economic recovery in the industrial countries, especially the United States, followed by Japan and other countries. Continued discipline in the management of fiscal and monetary policy in those countries had brought down inflation and interest rates, developments that had also assisted the efforts of indebted countries.

It was not necessary to go into a detailed analysis of the causes of the financial crisis that had been experienced, Mr. Fujino continued. The process had been costly, but lessons had been learned. The end of the tunnel had not been reached, even though light could now be seen in the distance. Therefore, it was necessary to emphasize the need for perseverance in adjustment efforts and the maintenance of a favorable environment over a long and difficult period. Continued adjustment efforts by indebted countries were called for to restore normal relations between debtors and creditors with commercial banks and to secure a regular flow of assistance from creditor countries. Industrial countries also had an important role to play in creating a favorable environment by maintaining sustainable growth without inflation and by lowering interest rates through disciplined financial policies. It had to be borne in mind that failure to create such a favorable environment or to achieve the necessary adjustment could easily lead to a deterioration of the debt problem.

Referring first to developing countries' external indebtedness to commercial banks, Mr. Fujino reiterated that the central issue was the firm intention of debtor countries to maintain a basic adjustment policy stance, not only with respect to macroeconomic policy but also in removing structural rigidities in industry, in the labor market, and in the trade and foreign exchange systems. In that respect, it was encouraging to note from SM/85/61 that the slow pace of bank lending in 1985-86 would not necessarily be a source of major concern. With continued efforts by debtor countries, it was to be hoped that normal relations between creditors and debtors in an efficiently functioning market would be regained in due course. To create a favorable climate for an early return to normal conditions, industrial countries would also have to continue their efforts to conduct economic policy so as to reduce inflation and lower interest rates.

The Fund played a highly valued role, not only because it provided its own resources to debtor countries but also because it functioned as a catalyst in inducing commercial banks to provide rescheduling and concerted lending to debtor countries, Mr. Fujino observed. Without Fund involvement, it would not have been possible to link debt rescheduling and concerted lending by banks to the adjustment policies of indebted countries in an efficient manner. It was also important that concerted lending by banks--or so-called new money--was provided not simply as one source of external financing but as effective leverage to promote economic adjustments.

In the process of difficult debt renegotiations, Mr. Fujino remarked, greater flexibility had been imparted to the exercise. For countries that had made significant progress toward adjustment, new features had been added to the terms of restructuring, involving multiyear arrangements, redenomination of part of the loans into domestic currencies, longer maturity and grace periods, and the reduction of fees and the spread over LIBOR. Such favorable new terms would not only contribute to relieving the debt service burdens of the countries concerned but also work as an inducement toward further adjustment efforts by other countries. By requesting the Fund to make arrangements for enhanced Article IV surveillance of its economy in relation to such a multiyear rescheduling, a debtor country would help to improve its creditworthiness. He supported a role for the Fund in that enhanced surveillance, although caution would have to be exercised. First, the Fund was not and should not be seen as taking the responsibility of guaranteeing a country's obligation to commercial banks. Second, uniform or mechanical guidelines in the application of enhanced surveillance would not be practical. The Fund could best exercise such surveillance by tailoring it to the individual circumstances and need of each debtor country.

His authorities had expressed strong support for cofinancing between commercial banks and the World Bank, Mr. Fujino remarked. In particular, Japanese commercial banks had actively participated in all the so-called B loans launched since January 1983, their share being close to half of the $1 billion total. In a period of modest spontaneous banking flows, more active participation by a wider range of banks was desirable and should be encouraged.

Since mid-1982, when widespread payments difficulties had emerged, the Paris Club creditor countries had dealt properly and flexibly in responding to the official debt rescheduling needs of debtor countries, Mr. Fujino considered. It was fair to say that creditor countries had played a major and effective role in supporting debtor countries' adjustment efforts to contain difficult debt problems. The analysis in the staff paper was to the point and clarified the circumstances.

With respect to the role of the Fund in relation to official creditors, Paris Club creditors required, as a precondition for the initiation of debt renegotiations with a Fund member country, the approval of a Fund-supported program, Mr. Fujino remarked. Yet arrangements with the Fund were often not brought to the Executive Board for approval until there was a clear indication that debt negotiations between the member country and its official creditors would soon take place. Therefore, the management and staff should be encouraged to remain in close touch and to exchange necessary information with the Paris Club. He had no difficulty with the suggestion that the Fund staff could help, on an ad hoc basis, to solve technical problems arising between official creditors and banks, provided that the advice was limited to purely technical problems.

Multiyear restructuring arrangements with respect to official credits would indeed have the advantage of allowing a debtor country to promote adjustment from a relatively long-term viewpoint, Mr. Fujino said. However, creditor countries would be cautious about entering into such arrangements, which would extend over several years and entail a heavy burden on a government under severe pressure to cut expenditures and reduce fiscal deficits. The slightest possibility that more flexible restructuring arrangements might weaken the adjustment effort of the debtor country would make the decision more difficult to reach. His authorities were of the view that multiyear official restructuring arrangements could not be based on predetermined uniform criteria. Decisions to enter into such arrangements should be made on a case-by-case basis, in order to make the best contribution possible to the success of debtor countries' adjustment efforts.

The multiyear restructuring of official credit could not be linked to the prolonged use of Fund resources, Mr. Fujino considered. However, his authorities hoped that enhanced surveillance by the Fund would be considered further in that connection.

As for the prolonged debt servicing difficulties of low-income countries, to which the Director of the Exchange and Trade Relations Department had referred in his opening statement, in addition to financing through debt relief, continued aid flows should be provided over the medium to long term, including those from the World Bank and regional development banks as well as other bilateral donors, in order to contribute to the solution of those countries' economic difficulties, Mr. Fujino considered. Those problems should be dealt with in appropriate forums, such as consultative group meetings. At the same time, it was important to facilitate the exchange of information between the Paris Club and consultative group meetings to make possible a comprehensive approach to both debt relief and concessional assistance.

The revolving character of the Fund's resources might inevitably lead to a negative net flow of Fund resources to members having had successive programs supported by an arrangement with the Fund, even during a specific program period, Mr. Fujino noted. It would be detrimental to the basic role and character of the Fund to treat such cases of negative net flows of Fund resources as exceptions; the Fund had gone as far as it could in such cases. An overall study and examination of each case would be necessary, including the possibility of financing from other sources, including the World Bank and regional development banks.

The staff study of export credit cover policies had usefully summarized the three phases in the process of debt accumulation and the resultant rescheduling, Mr. Fujino noted. Several points deserved attention. First, in considering the relation between trade financing and debt problems, full recognition had to be given to the fundamental principle underlying policy action by export credit agencies, namely, that they were financially self-supporting. However, export cover policies had a great impact on the economic management and debt servicing capacity of the recipient countries. Therefore, while the need for financial discipline should be kept in mind, specific policy actions should be determined on a case-by-case basis, depending upon the economic conditions of the individual recipient countries.

On a related point, Mr. Fujino welcomed the greater flexibility shown recently by many export credit agencies in dealing with debt servicing difficulties, provided that the debtor countries met certain conditions. Obviously, the only way to resolve debt problems would be through the determined efforts of the debtor countries themselves. At the same time, however, where debtor countries were successfully pursuing adjustment strategies, flexible and cooperative action by creditors would be appropriate and would help to normalize relations between creditors and debtors at an early stage. More specifically, he welcomed the continued provision by many agencies of short-term cover, even after reschedulings, provided that short-term debt was excluded from the reschedulings and that certain other conditions were fulfilled.

According to SM/84/272, some of the requests from certain debtor countries for rescheduling by the Paris Club had proved counterproductive, with respect to retaining financial flows from creditors, Mr. Fujino said. The staff paper pointed to the tradeoff between debt rescheduling and the terms of new cover. He hoped that debtor countries would be fully aware of such relationships and of the ground rules of export credit agencies so that they could take advantage of the flexible approach of such agencies.

His authorities believed that it would be difficult to achieve a formal and full harmonization of cover policies among various export credit agencies, Mr. Fujino stated. First, each agency had to maintain its own financial discipline and decision-making sovereignty. Second, the systems differed greatly across agencies. Accordingly, the problem should be dealt with on an informal and case-by-case basis. It might be useful to seek a closer exchange of information through existing forums, such as the Paris Club or the Export Credits Group of the OECD. Finally, use of trade financing as an integral part of financing packages to fill external financing gaps seemed to give rise to certain problems. As mentioned in the staff paper, medium-term export credit flows followed commitments with a considerable lag. Second, making accurate estimates of the ex ante financing demand and establishing the appropriate commitments of individual agencies also posed difficulties. In view of those problems, his authorities felt that a rather cautious, case-by-case approach to exploring the possibility of including trade financing in such packages was necessary.

Mr. Jaafar observed that it seemed fair to conclude that considerable progress had been made in resolving the global debt problem since the crisis had broken out in mid-1982. It could probably safely be stated that the worst was over, unless the global economic environment deteriorated more than was currently expected. The major issues ahead that called for attention were the obstacles to an open trading system and factors to sustain orderly growth. The Fund should be singled out for its admirable action in containing the debt crisis, by using its unique ability to attach economic conditions to the financing that it provided.

The time had come to take stock and to propose new solutions for the future, Mr. Jaafar continued. In passing, he noted that the progress made had not been without cost for the debtor countries; it had been achieved with great sacrifices. However, growth had resumed, trade had begun to expand, and the need for external financing had abated with the dramatic improvements in current account positions. Although the debt servicing burden had also been alleviated, it was still disturbingly high, and its maturity profile remained a concern, in spite of some improvement as a result of restructuring. The fact was that, even with a further improvement in the trade position, debtor countries' net borrowing would remain considerable, and it was an open question whether their demand for credit could be met. Those and other considerations put forward by other Executive Directors suggested that it would be necessary for financing flows to continue unabated, and hopefully with some improvement in their quality, based on the sobering experience gained over the past few years.

It was also time for the Fund to consider and promote longer-term solutions to the debt problem consistent with ensuring normal access of debtor countries to credit and capital markets, Mr. Jaafar remarked. Many of the elements of such a solution were already embodied in the various staff papers under discussion. For highly indebted countries that had made substantive progress in economic adjustment, he would suggest first that consolidation of debt on a longer-term basis was inevitable, because of the profile of maturing debt over the past two years as well as for the years ahead. The Fund should make that point clearly at the forthcoming spring meeting of the Interim Committee. For example, for 1983 and 1984, he had seen figures of about $40 billion for debt servicing payments that had had to be carried forward, not to mention the large proportion of the debt itself that was short term. The hump in payments in the years ahead was equally troublesome. If rescheduling arrangements had not been agreed, some countries would have been overwhelmed by the bunching of maturities in 1983 and 1984, and a similar outlook appeared inevitable in coming years.

Year-to-year rescheduling was not a satisfactory solution, Mr. Jaafar considered, because it would only prolong the atmosphere of crisis and would not assure a return to normal relationships with banks. The best alternative was multiyear restructuring arrangements. Countries that had made visible progress toward economic adjustment and had improved their ability to pay should, like Mexico, have the benefit of such restructuring arrangments. However, that solution left unanswered the difficult question of how to deal with the so-called residual category of highly indebted member countries that were no less in need of similar restructuring arrangments. To promote multiyear restructuring arrangements only for those countries that had earned it did not seem to be a rational way of dealing with the bunching of maturities and refinancing needs; it would be more appropriate to tackle that problem as part of the whole rescue package. In order to retain some flexibility, the Fund should use its influence to persuade the banks of the appropriateness of multiyear restructuring arrangements in certain cases.

In countries that had demonstrated an ability to dispense with use of the Fund's resources, surveillance could make a significant contribution by fostering continuing adjustment, Mr. Jaafar noted. The circulation of consultation reports to creditors might well be useful, but he could not support such a procedure, which would have to be considered within the context of the membership as a whole. He did not dissent from the view that an individual member, on its own initiative, could circulate a staff report for an Article IV consultation, but the Fund should not take such cases as a precedent for general circulation. He fully agreed with the statement that enhanced surveillance was not a substitute for monitoring by commercial banks themselves. In the final analysis, the banks would have to make their own assessment of what debtor countries were able to pay, based on information available to them in the marketplace.

He also supported the call for action by official creditors to offer multiyear restructuring arrangements, Mr. Jaafar remarked. However, he had seen little evidence so far that official creditors were taking seriously their declared intent to promote a more flexible approach to rescheduling, as stated in the Williamsburg Declaration and later reaffirmed at the London Summit. One possible rationale might be the desire to make countries earn such arrangements; Mexico, for example, had qualified on that score. The reservations that he had expressed on the broader application of multiyear restructuring arrangements by commercial banks also applied to arrangements offered by official creditors. The Fund should persuade the Paris Club to change its attitude toward multiyear restructuring arrangements. The provision by some governments of bridge financing, pending such arrangements, should be continued.

He fully endorsed the staff's views on banking supervision, Mr. Jaafar commented. However, it did not seem necessary for commercial banks, in trying to strengthen their balance sheets--for instance, by obtaining a higher capital/asset ratio--to reduce their exposure to debtor countries. Other alternatives were available to them.

The comments that he had already made applied equally to countries still at an early stage in resolving their debt service difficulties, Mr. Jaafar stated. He could also endorse the four points made in the opening statement by the Director of the Exchange and Trade Relations Department, with the qualification that a linkage should not always necessarily be established between a Fund-supported adjustment program and rescheduling.

For countries continuing to experience protracted debt servicing difficulties, the staff papers offered little in the way of a solution, especially with respect to the refinancing needs of low-income countries, Mr. Jaafar considered. Multilateral and bilateral arrangements on concessional terms would seem to be the most appropriate solution. In the longer term, it would be necessary to look beyond restructuring and managed lending. Besides official development assistance, which had a special place, it would be necessary to improve the conditions for spontaneous credit, direct investment, and the return of flight capital. Those issues should be underscored at the forthcoming spring meetings.

As for export credit cover, Mr. Jaafar noted, the paper by the Fund staff and that by the World Bank staff had highlighted the duality of the role played by export credits. On the one hand, such credits had formed a key element of financial flows to developing countries in recent years, particularly to low-income countries lacking ready access to commercial bank financing. In that respect, export credit had played an important role in development finance. On the other hand, while not intended for that purpose, export credits in practice had taken on a major role in balance of payments financing as well, in that an interruption of the flow of export credit would represent negative balance of payments financing.

Export credits benefited both importing and exporting countries, Mr. Jaafar observed, and it was therefore obviously in the interests of both parties to maintain a continuous flow and maximize its effectiveness. The key would seem to lie in better flows of information and improved administration, to which all parties concerned could contribute at all stages of the process of granting export credit. Initially, borrowing countries should make known their development priorities as well as their economic circumstances. Consideration could be given to central screening of projects for feasibility, design, and timeliness in order to enforce discipline. For their part, export credit guarantee agencies should look at the specifics of particular projects and not only at the macroeconomic situation of the borrowing country. In that respect, he had taken note of the measures adopted by many agencies to appraise countries' situations and specific projects, and in adjusting country limits and developing sound lending standards. Multilateral financing institutions could contribute greatly in evaluating projects.

At the debt rescheduling stage, Mr. Jaafar added, attempts would have to be made to maintain the flow of financial resources so that the countries in question could return to a sustainable external position. According to the staff paper, the policies of most export credit guarantee agencies with respect to both the maintenance and the nonmaintenance of cover were similar, although in practice decisions were made on a case-by-case basis, with significant weight being given to the relationship between the two parties. While he understood the desire of agencies to make discretionary judgments, it would seem beneficial to both parties if the considerations taken into account by the export credit agencies were made known to the borrowing countries. That was particularly true where there was a possibility of a direct tradeoff between debt restructuring and new export credits. Decisions could then be made in full knowledge of the implications.

Finally, Mr. Jaafar noted, export credit guarantee agencies had a variety of instruments at their disposal to influence the extension of cover. Thus, the agencies should be able, as in the past, to implement any policy changes gradually and without severe interruptions that would harm the adjustment efforts of the borrowing countries.

Mr. Zecchini mentioned that the close connection between the financial outlook for the developing countries and their underlying real economic prospects made it difficult to consider the problem of developing countries' indebtedness separately from--or even prior to--the Executive Board's discussion of the world economic outlook. The policies that could be suggested to adjust a given pattern of financial flows depended heavily on underlying trends in the current balance of payments, which in turn depended on the economic cycle and the policies pursued by both creditor and debtor countries. As he understood them, the evaluations by the staff of the medium-run financial prospects for developing countries were essentially drawn from the so-called base line scenario of the world economic outlook, which assumed a continuation of the recovery in the industrial countries at a yearly rate of about 3 percent through 1990 and real export growth for indebted countries of about 6 percent. Those assumptions seemed to be broadly appropriate and to constitute an adequate basis for the discussion in both the Executive Board and the Interim Committee. However, elements of uncertainty remained in the underlying economic trends themselves, particularly insofar as the pace of recovery in the industrial world and its effects on developing countries' current payments were concerned.

There were grounds for viewing the current financial situation with a fair degree of confidence, Mr. Zecchini believed. The international banking community had responded flexibly to the need to provide the necessary financing to countries engaged in adjustment efforts. At the same time, the process of strengthening the capital base of banks, needed in the circumstances, had been advanced. On the side of official creditors, flexibility and innovation had been less pronounced, but it was legitimate to hope that progress could be made in the near future. Export credit cover agencies had adapted their policies to the changing environment, and countries in payments difficulties had often been able to maintain a flow of essential imports for which export financing by industrial countries had been ensured. In the whole process, the Fund continued to play a crucial role, coordinating the efforts of debtors and creditors in an attempt to achieve the best combination of adjustment and financing, given the constraints on the availability of financial resources. If current world economic conditions continued to be favorable, that process could continue to operate, although with some improvements in a few specific areas.

One area in which progress could be expected related to the modalities for official debt rescheduling, which had so far been characterized by considerably less flexibility and innovation than rescheduling operations by banks, Mr. Zecchini went on. The reason, to some extent, was that there had been less need--on the part of both lenders and borrowers--for more flexible forms of official debt rescheduling. However, it would be advisable for at least one of the recent advances in private rescheduling--the multiyear framework-to be extended to official operations as well. That would undoubtedly improve the chances of debtor countries to restore their normal access to markets because they would be able to make financial plans further ahead and with greater certainty. The prospects of a long-term solution for the rescheduling of official debt were good for at least one country, and it would be interesting to know more about the prospects for all other countries. To the extent that multiyear official rescheduling lessened the debt service ratios of developing countries and restored their normal access to financial markets, it would be crucial to avoid the recurrence of some of the conditions that had led those countries to overborrow in the 1970s. To that end, the surveillance role of the Fund should be strengthened, and ways should be devised to induce the banking community to improve its methods for appraising credit risk.

Financial innovation, especially in the securities market, was a second issue that had recently attracted attention, Mr. Zecchini noted. In fact, the recent buoyancy of that market had been linked strictly to such innovation, which had sustained the demand for securities in a world pervaded by considerable uncertainty about interest rates and credit risks. Although that development had so far been limited essentially to interbank flows, the question had been raised whether more flexible financial instruments could contribute to a better distribution of risk in the markets, and ultimately contribute to the solidity of the system and possibly to the restoration of normal flows to developing countries. Unfortunately, available indications did not justify excessive optimism on that score. The newly introduced financial instruments had so far contributed mainly to channeling funds to the industrial world, and there were no signs of an early change in that tendency. The difficulty in assessing risk in international lending to developing countries had been one of the major factors behind the relative shift away from bond financing during the 1970s, and that factor was still largely present. Even if the flow of lending to industrial countries made it easier for them to grant more export credit to developing countries, it seemed likely that a large share of the burden of credit and related risk would still have to fall on the banking system, either directly or through back-up facilities.

The issue of risk assessment in international lending was in turn closely related to the Fund's role, both present and prospective, Mr. Zecchini remarked. As the staff had correctly put it, such a role would have to depend on the stage at which each individual country found itself in the process of dealing with its economic imbalances. For debtor countries that had already proceeded a long way toward external adjustment, and for which multiyear arrangements had been negotiated with creditor banks, it seemed appropriate for banks to take over complete responsibility for assessing and monitoring their creditworthiness, with the Fund continuing to exercise surveillance as usual over economic policies. The primary reason for such an approach, as mentioned in the staff paper, was that information on solvency must come from a number of different sources. A secondary reason was that, as countries moved toward normalizing their relationships with markets, the emphasis in risk evaluation might to some extent shift back from the country level to the level of individual direct borrowers, whose solvency was determined by elements that were in part different from those affecting the solvency of the country as a whole. It would not be appropriate for the Fund to continue to have a major responsibility for assessing credit risks in those circumstances; its main function in the current world economic situation should be to guide the adjustment process.

Export credit cover agencies could make a major contribution by influencing the level of exposure of the banking system in specific markets, Mr. Zecchini observed. Therefore, a further improvement in those agencies' capacity to assess the situation of both countries and specific projects would also be needed.

Entirely different considerations applied to the so far more numerous case of countries still in the early stages of economic adjustment, whose debt negotiations were being carried out in a short-term framework, Mr. Zecchini remarked. For those countries, the link between the involvement of banks and Fund-supported programs on a country-specific basis would continue to be necessary, given the countrywide nature of the problems.

In sum, Mr. Zecchini said that he remained concerned with the medium-term outlook of indebted developing countries. The nature of his concern, however, related much more to the uncertainties of underlying economic conditions than to the adequacy of current financial flows. If the favorable trends prevailing in the world economy could be sustained, his chair was of the view that the present collaboration of official creditors, private creditors and the Fund should continue on a country-specific basis. Within that framework, some improvement could be made in the techniques of official rescheduling exercises, and the Fund's performance as a catalyst should be adjusted according to the stage of economic adjustment reached by each country.

Mr. Mtei considered that the main issues flagged in the statement by the Director of the Exchange and Trade Relations Department were central to the problem of developing countries' external indebtedness. The forthcoming discussions on the world economic outlook would provide yet another opportunity to explore further the economic policies most appropriate for the resolution of the debt problem. Consequently, his observations on developing countries' external indebtedness would be brief.

On the face of the evidence, the risks threatening the international financial system in mid-1982 as a result of widespread debt service problems had receded, Mr. Mtei remarked. However, the situation of many developing countries remained critical. Total debt as a percentage of gross domestic product and debt service ratios was still very high, for individual debtor countries as well as regionally or globally. If anything, the various rescue operations undertaken since 1982 had only provided the international community with much-needed breathing space to think more seriously about finding a permanent solution to the debt problem.

Against that background, Mr. Mtei agreed with the staff that policy actions to that end were now required. Crucial in that context were the conditions and measures to stimulate adequate financial flows to developing countries, and most important, to the debt-ridden ones. The need for appropriate policy measures in the debtor countries themselves could not be overemphasized, but neither could action on the part of commercial banks, export credit agencies, and official sources of credit. The staff had dwelt at length on how to ensure adequate financial flows through those channels. But multiyear restructuring arrangements had a particularly important role to play in lightening the burden of countries described as highly indebted by removing the hump in their amortization payments. The recognition by the banks of the need for multiyear rescheduling and their agreement in principle to reschedule three countries' debts on that basis--and to give serious consideration to such rescheduling for two other countries--could be regarded as a positive indication that the banks were prepared to attack the problem at its roots. He could only hope that such restructuring arrangements would become available in other deserving cases.

One phenomenon brought out clearly in the staff papers was the unprecedented rise in the number of countries requesting debt relief, together with an increasing number seeking repeated rescheduling, reflecting the widespread and urgent debt service problems facing many countries, Mr. Mtei continued. It was also noteworthy that low-income countries, particularly in Africa, represented a sizable proportion of countries having had their debt rescheduled in recent years: 10 out of 16 countries seeking debt rescheduling in 1983, and 9 out of 13 in 1984, had been in Africa, suggesting that the debt problem was as great in that region as in others, if not more acute. Those countries might not be so highly indebted that, either individually or even perhaps in aggregate terms, their debt endangered the international financial system; but in terms of the size of their economies and their debt carrying capacity, the situation was more critical than was generally recognized. Those countries had little or no access to private capital markets and therefore could not benefit greatly from multiyear restructuring of commercial bank debt, even if such restructuring became more prevalent, because the bulk of their debt was owed to official creditors.

He was aware of the flexible coverage and terms of recent official multilateral debt rescheduling arrangements, reflecting the awareness of official creditors of the need to respond to the special needs of highly indebted countries, Mr. Mtei added. However, there was much more to be done, and a positive step toward multiyear rescheduling of debt owed to official creditors would contribute immensely to a more durable solution to the debt problem because it was likely to have a salutary impact on the attitude of banks to multiyear rescheduling. To that end, he agreed with the staff that a multiyear rescheduling approach could easily be accommodated within the traditional procedures of the Paris Club. Apart from easing the debt burden, multiyear rescheduling would free the top financial experts of the indebted countries from the pressures and constant travel often associated with single-year rescheduling exercises.

However, a pragmatic approach would call for innovation in existing practices, particularly in dealing with low-income countries facing structural balance of payments problems, Mr. Mtei concluded. For instance, at a time when the Fund was arguing that its resources were not meant to be used to support structural adjustment, the rationale for insisting that a Fund-supported program should always be in place in those countries before agreement was reached on a rescheduling arrangement did not appear strong. What was important was not having the Fund arrangement in itself, but ensuring that rescheduling would be accompanied by serious adjustment efforts in debtor countries through reasonable monitoring procedures. He was not denying the relevance of the Fund or the possibility of its being the monitoring agency. Provided that agreement could be reached on monitoring procedures, rescheduling need not be a substitute for funds from other channels, such as export credit agencies in the form of guaranteed trade financing. In fact, increased resource flows from the latter source should complement the scheduling flows, and not vice versa. Further debt relief could be effected through the conversion of debt owed to bilateral official creditors into grants and through positive steps to reduce the interest burden on debtors having had recourse to the market at floating rates.

Mr. Schneider said that he shared the staff's view that progress had been made during recent years in resolving the debt problem of the developing countries. A number of factors had been responsible for that progress, including the close cooperation between the Fund, commercial banks, and official lenders that had resulted in concerted rescheduling operations, the recovery in the industrial world, and continuous, strong adjustment efforts by the developing countries. The rescheduling exercise had been successful so far in averting a financial crisis, but it had been clear from the outset that real success would not be possible until debtor countries' export receipts were once again brought into a more or less reasonable relationship with current foreign debt commitments. The prerequisite for easing the burden was successful adjustment of the real economy: financial rescheduling operations alone were not enough.

However, until recently, circumstances had not favored efforts to cope with the adjustment process, Mr. Schneider added. The extremely high interest rates in the dollar area and the stagnation of world trade in 1982/83 had made it impossible for developing countries to offset high interest costs by increases in the volume of exports. As a result, over-indebted countries had been unable to channel a considerable proportion of the fresh money provided to them into productive investment but had had to use it for debt service payments. It was therefore unsurprising that the number of countries in the process of rescheduling their debts had consistently drawn attention to the social and political limits surrounding a policy of economic redressment. The difficulties of coping with economic adjustment demonstrated that cutting imports was not a solution, because it would seriously undermine the basis for future growth. Since adjustment programs inevitably took a long time to show results, the proposal to design rescheduling operations with a longer time horizon was welcome. He also supported so-called enhanced surveillance by the Fund, aimed at facilitating monitoring procedures by creditor banks without relieving them of their own responsibilities.

It should not be forgotten that the debt problem would remain alive for the foreseeable future, because external and social factors would not permit its prompt solution, Mr. Schneider said. Nevertheless, the world economic outlook projections on debt issues and the current account deficits of the developing countries had shown that a gradual solution of the debt problem might well be reached, with appropriate policies in both debtor and creditor countries accompanied by adequate financial flows to the debtor countries. A satisfactory solution would thus require considerable cooperation among all parties, with a central coordinating role for the Fund.

A cooperative approach had a basis in the theory of public goods, initially developed by Paul Samuelson in the 1950s and frequently invoked to place the debt issue in a wider perspective, Mr. Schneider continued.

According to that theory, the restoration of debtor countries' creditworthiness would be a public good for the lenders, first, because without it the value of old claims would be reduced to the extent that the pool of resources available to service those claims was reduced; and second, because new profit opportunities would also be lost. According to the theory of public goods, the optimum public benefit could be derived only through concerted action on the part of the public and private sectors. The question remaining was what action could be taken to improve the creditworthiness of debtor countries. There were several possible answers to that question, but he would keep his remarks within the limits set by the scope of the staff reports and statement.

At least some of the approaches and actions mentioned in the statement by the Director of the Exchange and Trade Relations Department seemed appropriate, Mr. Schneider considered. For those countries having made substantial progress in their adjustment efforts, multiyear restructuring with extended maturities for future amortization payments, together with an increase in export credits guaranteed by governments, would certainly facilitate the required adjustment. Special attention would have to be paid to the difficulties of the lowest-income countries, especially in Africa. The catalytic role that the Fund could play in those places should be complemented by special action by the World Bank. At the same time, the sensitivity of the debt problem of developing countries to exogenous factors could not be ignored. In fact, high interest rates and interest payments, although totally outside debtor countries' control, severely limited those countries' efforts at an orderly and speedy adjustment. A significant reduction in international interest rates would certainly be a crucial element of a workable set of measures for dealing with the problem at hand.

With respect to the international banking system, Mr. Schneider observed, the banks' main concern so far had been to maintain the book value of their claims on debtor countries and to maintain the returns from those claims over the short term. The prime objective of the lenders as lenders should have been to restore the creditworthiness of the debtors. It was hardly astonishing that individual lenders had not done more to restore the creditworthiness of debtor countries because both the costs and the benefits to be derived would depend on similar action by all lenders. And the interests of the multitude of banks on the various advisory groups were far from identical. Experience had shown that the large banks, which were heavily involved in the debtor countries, had preferred to secure their claims and income by granting additional financing. The smaller, regional banks, which were generally less involved, were more ready to write off their claims. That divergence of interests had not been especially favorable to a rapid restoration of debtor countries' creditworthiness.

Another issue discussed in the staff papers was how to strengthen the international banking system, Mr. Schneider remarked. It was in the interests of all to strengthen banks' balance sheets. Measures had been taken to increase capital/asset ratios by classifying nonperforming loans at the expense of banks' profit margins. He fully concurred with that approach because it was much more important to safeguard the viability of the banking system than to pay higher dividends to stockholders. Another approach was to improve risk assessment, especially sovereign risk, keeping in mind that each bank had the responsibility for assessing its own risk; banks should not rely on assessments made by other institutions that might be guided by different lending policies. Such an approach would not only assist individual banks in distributing their lending more rationally, but would also increase the soundness of the banking system as a whole. As the staff had stated, Fund surveillance of a country's economy should not result in giving a signal to commercial banks that they could relax their own watchful monitoring. It would also be desirable if banks could tighten cooperation among themselves with respect to their total exposure within a given country, but fierce competition probably made that approach difficult.

Despite the descriptive explanation in the staff paper of nonguaranteed supplier credits, little had been said about how to approach the rescheduling of debt owed to the suppliers of such credit, Mr. Schneider noted. Although such rescheduling was of a more complex nature than other types of debt rescheduling, and although the staff favored a highly flexible, case-by-case approach, the Fund should take a more active initiative to help both sides by developing some general techniques and approaches. If it was accepted that a more global and cooperative approach to the resolution of debt problems was required, there would be no reason to exclude debt to suppliers of nonguaranteed credit.

Mr. Lundstrom stated that the Nordic countries generally shared the views presented in the staff paper on developing countries' indebtedness to commercial banks. Further efforts by both debtor and creditor countries were needed if debt problems were to remain manageable. The expected continuation of a low level of bank lending in coming years, and the uncertainty surrounding developments thereafter, suggested that the importance of such efforts should have been more strongly emphasized. In addition, the Fund should stress to the banks that adjustment policies had gone very far in a number of debtor countries. To achieve a resumption of spontaneous bank lending, it would probably be important for the Fund to continue to participate in various forms of enhanced surveillance. However, he joined the staff in underlining that it was essential not to let the Fund be seen as a guarantor of bank lending. He also agreed with the staff that banks--in the same way as official creditors--should respond flexibly to countries experiencing severe debt service difficulties over an extended period. In certain cases, it might prove necessary for banks to contemplate substantial debt relief, which obviously would have to be paralleled by comprehensive adjustment measures by the country in question, with the aim of achieving long-term viable debt servicing capacity. The Fund and the banks should continue to take coordinated action on a case-by-case basis. To the extent required, the Paris Club should be involved at an early stage in order to ensure comparability and equitable burden-sharing.

The staff study of the policies of export credit agencies was of particular value in connection with the acute debt problems of debtor countries, Mr. Lundstrom commented. Export credits and guarantees constituted an important part of total financing to many developing countries. If export credit guarantees were not to turn into subsidies, the agencies should strive to live up to the GATT norm, namely, of financial self-sufficiency in the medium term. The Nordic countries favored re-enforced cooperation on export guarantees within the Berne Union and in other forums. Complete uniformity of export credit terms might, however, have undesirable effects. Differences in the commitments made by different agencies might, for instance, be advantageous for debtor countries by reducing the likelihood of their being hit by sharp changes in sources of finance. The exchange of information among export credit agencies should in any case lead to a considerable degree of policy convergence. The implication of what he had said was that suasion with respect to cover should be avoided; the agencies should not be burdened with uninsurable risks.

There had been a tendency for export credit agencies to remain on cover too long in problem countries, Mr. Lundstrom remarked. The agencies had thereby incurred losses, and debtor countries had accumulated unnecessarily large debts. The problem arose because of the difficulty of assessing country risks beyond the short term, but also owing to market developments and competitiveness. On the other hand, the resumption of cover for a former problem country often took place with some delay. Apart from an understandable prudence, the lack of information--not least on the part of debtor countries--on the policies of agencies might be at fault. He shared the staff view that closer knowledge of the ground rules of agencies could reduce the limitations of cover and lead to a modification of debt rescheduling procedures. In step with credible internal and external adjustment measures by debtor countries, agencies could provide new cover; on the condition that the rules for short-term guarantees were adhered to, cover could in certain cases be maintained in part even during debt rescheduling negotiations.

The Fund's contribution to export credit guarantees lay primarily in the provision of information and in its surveillance activities, Mr. Lundstrom noted. Evidently, export credit agencies valued the Fund's country analyses and often sought additional information, for instance, on medium-term economic and financial developments. Fund-supported adjustment programs and debtor countries' performance under them were of central importance to the assessment by agencies of countries whose economies were recovering and of the appropriate timing of a renewal of exposure. A positive impact on the provision of guarantees could also be achieved if debtor countries--possibly assisted by the World Bank--established clear priorities with respect to their investment needs.

Equitable burden-sharing among creditors was regarded as necessary by the Nordic countries, Mr. Lundstrom said. He agreed with the staff that comparisons with that aim in view could not be made based on standardized formulas. But comparability of treatment would be furthered through an increased exchange of information, which was in the direct interest of the Fund if workable rescheduling arrangements were to be agreed. The Fund's knowledge of conditions and the technicalities of the treatment of various claims could make an important contribution in balancing the efforts of different creditors, thereby making it easier to achieve comparability in the treatment of claims. The Fund should consider how to make its contribution to greater comparability and hence more equitable burden-sharing. Comparability could also be strengthened if debtor countries were required, prior to negotiations in the Paris Club, to report in detail on agreements already entered into with other creditors or being negotiated.

A certain degree of flexibility might prove necessary in meeting the requirement of equitable burden-sharing vis-à-vis suppliers of nonguaranteed credit, Mr. Lundstrom noted, as the staff had mentioned. However, burden-sharing must remain the objective, especially as suppliers' claims in aggregate terms were large.

Although it would be in the spirit of equitable burden-sharing for official creditors to offer some kind of multiyear rescheduling arrangement in a case-by-case basis, where the adjustment policies and debt burden of a country warranted it, Fund surveillance would have a role to play in that connection, Mr. Lundstrom considered. The Paris Club was presently discussing the matter and had asked the Fund what type of procedures it could suggest when countries had no stand-by arrangements. That was a central issue for the Paris Club, as the staff had pointed out, because extended consolidation periods had so far been accepted in connection with stand-by arrangements.

In line with his remarks on cover policies, Mr. Lundstrom added, direct agreements between export credit agencies on guarantees connected with multiyear rescheduling arrangements would seem to be beyond reach, inter alia, because of different national rules with respect to cover.

With respect to countries experiencing severe debt servicing difficulties, Mr. Lundstrom said that he agreed with the staff that the need for reschedulings on exceptionally soft terms, as well as the ability of the country concerned to manage its economic situation, could best be judged on a case-by-case basis. However, the issue was of such topical interest that whether it should be discussed in the Paris Club might be worth considering. Even if the primary need in such cases was for development assistance, he agreed with the staff that debt relief on soft terms, in combination with a major and credible reorientation of economic policies in the debtor countries, could contribute to a restoration of confidence and improve the debt service profile in the medium term. Another question of credibility that arose was whether the Paris Club should enter into agreements--as it was already doing in some cases--that were viewed as unrealistic from the outset by the debtor country. It would be absolutely essential for commercial creditors to make corresponding concessions if demands were to be placed on the Paris Club for reschedulings on exceptionally soft terms.

Mr. Wang observed that with the improved world economy and more buoyant trade, debtor countries had made impressive progress in their adjustment efforts. The debt problem seemed to have been eased to a certain degree, and most of the major debtor countries had passed from the import-compression phase of adjustment to the export-expansion phase. However, those favorable trends should not be cause for complacency: the debt problem had only been contained, not resolved. For many rescheduling countries, repayment dates had been postponed and the debt service ratio thus reduced, but the debt burden itself had become even heavier because of rescheduling fees and higher interest rate spreads. Furthermore, the progress made by debtor countries had been uneven, with the majority still in dire difficulties. As noted by the staff, of the 23 countries obtaining debt reschedulings in 1983-84, about 80 percent were expected to seek further official reschedulings in 1985-86, and there was a distinct possibility that a number of countries might request further reschedulings in the years beyond 1986.

Thus, rescheduling did not appear to be the fundamental answer to the debt problem, Mr. Wang continued. Recent reports of difficulties in Latin America and the lengthening list of members with overdue payments to the Fund itself were clearly signs of the persistence of the debt problem, which could lead to a crisis at any time and in any country if not handled with caution and foresight. A comprehensive, long-term solution based on the combined efforts of all parties concerned was therefore needed. Together with persistent adjustment by debtor countries, a more favorable international economic environment was essential to the solution of debt problems. In that respect, industrial countries would have to strengthen their financial policies to bring about a lowering of interest rates while maintaining low rates of inflation. Furthermore, industrial countries would have to work toward reducing their trade restrictions and reversing the protectionist tendencies of recent years so as to expand the market for developing countries' exports. Unfortunately, little progress had been visible in that area, even though all sides had recognized the problem. In that connection, Fund surveillance would have to be strengthened; it was indeed indispensable if such policy measures of the industrial countries were to be evaluated.

To support adjustment in debtor countries, and to resolve widespread payments difficulties, Mr. Wang added, greater effort would have to be exerted in finding additional sources of financing. It was worth mentioning that export credit flows to debtor countries had become an important source of financing. Many debtor countries, in the current environment of payments difficulties, would find that form of financing of some help, and it should be expanded in future.

In general, any solution of the debt problem would rest with both creditor and debtor countries, Mr. Wang observed. Industrial countries, therefore, must be prepared to share the responsibility as well as the burden of resolving the problem because that was also in their own interest. The governments of those countries should support developing countries in their adjustment efforts by providing, in various forms, additional financial backing; that idea should have been emphasized much more fully in the staff papers.

As to the specific points made in the opening statement by the Director of the Exchange and Trade Relations Department, Mr. Wang noted, multiyear rescheduling arrangements, insofar as they reduced the debt burden of developing countries and introduced a sense of normalcy in the relationship between debtors and creditors, should be encouraged and extended to a greater number of suitable countries. The same type of arrangements should also be granted by official creditors. For countries still at an early stage in resolving their debt servicing difficulties, he expected the Fund to play as energetic a role--especially in making available Fund resources as well as in helping put together financing packages--for those countries as for major debtor countries.

As for countries with a weak economic base that were experiencing protracted debt servicing difficulties--especially, for instance, countries in Africa--creditors should be urged to adopt the more flexible and lenient measures which alone were realistic, Mr. Wang concluded. In particular, official creditors should seriously consider granting multiyear rescheduling arrangements to those countries, and over a long time span. Finally, he understood the term "catalytic" in that case as referring to the greater amount of financing elicited from other sources as a result of Fund support rather than limited Fund financing.

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

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/85/44 (3/18/85) and EBM/85/45 (3/20/85).

3. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/85/68 (3/15/85) and EBAP/85/69 (3/18/85) is approved.

APPROVED: January 22, 1985

LEO VAN HOUTVEN
Secretary