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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 85/46

3:00 p.m., March 20, 1985

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

Executive Directors	Alternate Executive Directors
A. Alfidja	
C. H. Dallara	M. K. Bush
	H. G. Schneider
B. de Maulde	X. Blandin
M. Finaish	T. Alhaimus
H. Fujino	M. Sugita
G. Grosche	
	Jaafar A.
R. K. Joyce	L. Leonard
A. Kafka	
H. Lundstrom	
E. I. M. Mtei	
F. L. Nebbia	
	J. E. Suraisry
	G. Ortiz
J. J. Polak	J. de Beaufort Wijnholds
C. R. Rye	A. V. Romuáldez
G. Salehkhou	
A. K. Sengupta	A. S. Jayawardena
	T. A. Clark
S. Zecchini	N. Coumbis
	Wang E.

L. Van Houtven, Secretary
K. S. Friedman, Assistant

Also Present

N. Hope, IBRD. African Department: J. C. Williams. Exchange and Trade Relations Department: C. D. Finch, Director; W. A. Beveridge, Deputy Director; S. J. Anjaria; E. H. Brau, J. T. Boorman, K. B. Dillon, L. H. Duran-Downing, G. G. Johnson, M. R. Kelly, G. R. Kincaid, D. A. Lipton, M. Nowak, S. Kanesa-Thasan, C. M. Watson. External Relations Department: C. S. Gardner, Deputy Director; H. O. Hartmann. IMF Institute: O. B. Makalou. Legal Department: G. P. Nicoletopoulos, Director; R. C. Effros, S. A. Silard. Research Department: W. C. Hood, Economic Counsellor and Director; A. D. Crockett, Deputy Director; R. R. Rhomberg, Deputy Director; D. J. Mathieson, P. J. Montiel, M. C. Williamson. Western Hemisphere Department: E. Wiesner, Director; S. T. Beza, Associate Director; J. M. F. Braz, J. Ferrân, B. C. Stuart. Bureau of Statistics: C. Briançon. Personal Assistant to the Managing Director: S. P. Collins. Advisors to Executive Directors: G. R. Castellanos, J.-C. Obame, T. Sirivedhin, E. M. Taha, D. C. Templeman, A. Vasudevan, M. A. Weitz. Assistants to Executive Directors: H. Alaoui-Abdallaoui, J. R. N. Almeida, W.-R. Bengs, J. Bulloch, M. B. Chatah, Chen J., J. de la Herrân, J. J. Dreizzen, G. Ercel, R. Fox, V. Govindarajan, N. Haque, G. D. Hodgson, A. R. Ismael, Z. b. Ismail, H. Kobayashi, R. Msadek, J. A. K. Munthali, K. Murakami, A. Mustafa, E. Olsen, A. A. Scholten, B. D. White.

1. ARGENTINA - REPORT BY MANAGING DIRECTOR

The Chairman commented that the staff had visited Argentina in February and March 1985 to evaluate the implementation of the stabilization program and the authorities' adherence to the performance criteria for end-December 1984. The rate of inflation had greatly exceeded the rate assumed under the program, and one of the performance criteria had been missed by a significant extent while some others had been missed by small margins. Even more important, the acceleration in the rate of inflation would make it difficult for the authorities to meet the end-March 1985 performance criteria expressed in nominal terms.

The Governor of the Central Bank and senior officials in the Ministry of Economy had met with the staff at headquarters on March 14; the Deputy Managing Director had chaired a further discussion among the staff and the authorities on March 15, and he had met with the President of Argentina that same morning, the Chairman said. The next step was to resume the discussions with the authorities in the near future in order to consider measures that would restore the adjustment momentum in the coming period. To that end, the staff intended to meet again with the authorities on March 27. He hoped that the staff and the authorities could agree on new measures and performance criteria for the coming months that could be approved by the Executive Board, thereby enabling Argentina to make the purchases that had been planned on the basis of performance for end-December 1984 and end-March 1985.

The latest discussions with the authorities had been constructive, the Chairman remarked. The authorities clearly wished to bring the adjustment effort back on track. Further progress had been made in finalizing the $4.2 billion bank financing package for Argentina, and it would be crucial to maintain that progress during the coming interim period in Argentina's adjustment efforts. Rapid and convincing steps must be taken to maintain the support of the international banking community. For that purpose, the Fund would have to explain clearly and frankly to that community how it intended to proceed in the coming period. Accordingly, the Deputy Managing Director would be meeting with bankers in New York on March 21, 1985 to explain the situation and to ask the banks to complete and maintain the financial package.

The Executive Directors took note of the Chairman's statement.

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

The Executive Directors continued from the previous meeting (EBM/85/45, 3/20/85) their consideration of staff papers on developing countries' external debt to commercial banks (SM/85/61, 2/20/85; and Sup. 1, 3/6/85) and official creditors (SM/85/62, 2/20/85; and Sup. 1, 3/1/85), and a paper on export credit cover policies and payments difficulties (SM/84/272, 12/18/84).

Mr. Sengupta commented that while the staff papers and the staff's opening statement at the previous meeting had brought into focus the many financing issues related to developing countries' external debt, they contained only a few global suggestions for improving the overall situation. That outcome was understandable, as creditors had approached debt problems on a case-by-case basis.

In 1983 and 1984, there had been some progress in coping with the debt servicing problems of debtor countries, Mr. Sengupta continued. In a number of cases, debt had been rescheduled, the maturity of debts had been changed, grace periods had been granted, the interest spread above the LIBOR on rescheduled debt had been lowered, and rescheduling fees had been reduced. All those developments had placed the countries concerned in a better position to service their debt. While the debt problem was still substantial, the experience of the previous two years had raised hopes that external debt could be serviced when creditors and debtors made the necessary adjustments in their approaches to solving the problem and when international institutions played an appropriate role. It was important to recognize that despite the sizable problems facing their economies, debtor countries had made commendable efforts to introduce harsh adjustment measures that had often caused serious import compression and reduced real growth rates and living standards. The adjustments had been particularly painful in African and other low-income countries.

The debt problems facing member countries should be placed in the proper perspective, Mr. Sengupta said. The developing countries correctly felt that their debt difficulties were symptoms of the need for economic development and that debt had become a serious problem because of the evolution of the world economy. The debt problem could not be solved unless the context in which it had arisen was taken fully into account. Sporadic emergency rescheduling and other short-term rescue measures might well improve a debtor's liquidity position, prevent large portions of member countries' debt from becoming nonperforming, and keep some debtor countries and the banking system from becoming insolvent, but they could not meet the main need, namely, to place debtor countries securely in a position to repay the interest and principal due in coming years. The developing countries' ability to make debt payments on time would depend upon the strength of their economic and financial position. In other words, the quality of the commercial banks' assets in the form of loans to developing countries should be improved. That objective could not be achieved by forcing debtor countries to make repayments at the cost of economic growth.

Some major debtor countries--most of which had had arrangements with the Fund--had recently moved from large trade deficits to sizable trade surpluses, Mr. Sengupta noted. However, gains made at the cost of abrupt, major reductions in imports, investment, and economic growth had involved risks of political instability and recurrent debt crises. Strong adjustment measures in debtor countries were obviously required, but they should be integrated with programs to achieve sustainable economic growth. Recording a short-term export surplus should not be the only aim of stabilization programs; indeed, it might be neither feasible nor desirable for debtor countries as a group to achieve sizable trading surpluses through structural changes and a reversal of protection in the developed countries.

Debt problems could not be solved in a piecemeal manner, Mr. Sengupta went on. An integrated approach was needed; the debtor countries, the commercial banks, and the international financial institutions all had important roles to play.

Debtor countries needed sufficient official and private financial support of policy packages designed to cope with external payments problems, Mr. Sengupta said. Accordingly, if debtor countries were to achieve sustainable growth, they would have to receive assistance in addition to debt relief. In fact, however, little progress in that area had been made. The Fund had stressed the need to obtain external viability through medium-term adjustment programs, but its direct contribution in the form of financing, and the period in which that assistance was provided, had been limited. Moreover, the World Bank's resources had not been strengthened, the growth of bilateral official lending had been decelerating, and commercial bank lending had declined.

The success of adjustment programs in debtor countries depended considerably on the trade climate they faced, Mr. Sengupta commented. Protection in industrial countries had often inhibited the adjustment process. Trade liberalization was nearly always required under Fund-supported adjustment programs, but such liberalization by developing countries alone resulted merely in the deterioration of the payments position of those countries.

As a rule, commercial banks should agree to multiyear rescheduling for highly-indebted countries, Mr. Sengupta considered. In the past, commercial banks had generally made the approval of a Fund-supported adjustment program a condition for a debt restructuring and had linked their own lending to purchases under arrangements with the Fund. However, the banks should not be bailed out; they must share the burden of solving the debt problem and help debtor countries to improve their debt repayment capacity. Commercial banks usually agreed to reschedule the principal of a loan, but increases in interest rates added considerably to the debt service burden, and some observers had suggested introducing interest caps and variable maturity loans, linking debt servicing costs to a country's export earnings, and converting past debt into debt serviceable at interest rates below current market rates. Those suggestions should be examined seriously, particularly in the light of the high real interest rates that debtor countries were still paying. While the debt servicing burden had been growing, commercial banks had greatly reduced their lending to developing countries, built up their reserves to cover loan losses, and raised additional capital. Apparently the purpose of commercial bank rescheduling was to ensure that the debts owed to the banks would be serviced in full, and that the banks' exposure in indebted countries could be drastically curtailed. As a result, multiyear rescheduling agreements often did not help highly-indebted countries to gain additional access to international capital markets, especially in the short run.

Relatively little attention had been paid in the staff papers to the impact of the overvalued U.S. dollar on the debtor countries, Mr. Sengupta remarked. In that connection, he recognized the problems that arose when liabilities were redenominated in domestic currencies or the ECU when the U.S. dollar was overvalued and interest rates were high or rising. Currency diversification of rescheduled liabilities should ideally reduce debt servicing costs if, as the staff had suggested, the diversification took place over an extended period. In making the decision on diversification, much depended upon the long-term outlook for the value of the dollar.

There was considerable merit in the staff suggestion to categorize problem debtor countries on the basis of the progress they had made in solving their debt difficulties, Mr. Sengupta said. However, it was important to note that the debt problems facing low-income developing countries--particularly those in Africa and South Asia--were related mainly to the use of official development assistance, export credit, and government loans, rather than to commercial bank lending. The situation in those countries was serious because of the decline in official development assistance in real terms, the contraction of IDA assistance, and the reduction of export credit facilities at a time when primary product prices had collapsed and the countries' access to capital markets had been drastically curtailed. Those countries needed multiyear debt restructuring agreements that were not conditional upon approval of an arrangement with the Fund.

The Fund could usefully devise a mechanism to monitor developments in countries seeking such agreements, Mr. Sengupta went on. It was the Fund's responsibility to ensure that low-income countries facing payments problems received adequate support. In that connection, special measures might be required, for example, the reactivation of the Trust Fund and interest subsidy account; recognition that the long-term structural adjustment of low-income countries called for adequate IDA financing and official development assistance; an agreement to write off the debt of the poorest countries while providing substantial relief for other low-income countries; and a reform of official debt rescheduling procedures to facilitate an increased flow of financial assistance. The international institutions, such as the Fund, the World Bank, and the regional development banks, should expand their resources and work closely with the official creditors of the low-income countries.

Export credit agencies provided a substantial amount of insurance and guarantees as well as direct export finance to developing countries, Mr. Sengupta noted. In recent years, the agencies had attempted to reduce their exposure by introducing ceilings on commitments, requiring irrevocable letters of credit, raising basic premium rates on surcharges, and suspending cover. Those measures had reduced the credit ratings of debtor countries and their access to international capital markets. Early agreement on the UNCTAD's proposed export credit guarantee facility would help to ensure a steady flow of such credit to developing countries. Agencies should restore export credit to debtor countries that were clearly introducing adjustment measures either entirely on their own or under an arrangement with the Fund. It would be useful to conduct a survey of debtor countries' attitudes toward the functioning of export credit agencies. In addition, the Fund and the World Bank might be able to provide assistance to export credit agencies with a view to improving their performance.

Mr. Finaish commented that the framework that had evolved over the previous several years to deal with the debt problem had significantly contributed to the stabilization of the overall debt situation and had helped to prevent a crisis in the international financial system from occurring. That outcome had been made possible by the efforts of all the parties concerned; the adjustment policies of debtor countries, the increased flexibility of creditor groups, and the Fund's efforts to coordinate the evolving process had all played a role.

Whether or not progress would continue to be made depended upon a number of factors that, unfortunately, seemed to be shrouded in uncertainty, Mr. Finaish continued. On the one hand, the prospects for exports of debtor countries depended on the sustainability of the present recovery in industrial countries and on the accessibility of those exports to foreign markets. Without a reduction in protection in industrial countries to support debtor countries' efforts to promote exports, a sustained recovery in the debtors' balance of payments was unlikely. On the other hand, the manageablility of the debt service burden would depend on, inter alia, movements in international interest rates which, in turn, were essentially determined by the domestic policies of industrial countries. The sustainability of the balance of payments adjustment achieved thus far in debtor countries would also depend on whether those countries would be able to restore adequate economic growth. Those uncertainties suggested that in the coming period concerted efforts would be needed by all the parties concerned--including debtors, creditors, and the Fund--to respond to the changing environment in a pragmatic way with a view to finding feasible solutions to problems that might arise.

The recently evolved approach to handling debt service difficulties, which had been described well in the staff papers, seemed largely appropriate, given the exceptionally widespread debt problems, Mr. Finaish said. However, as those problems receded and normal conditions returned to the international lending system, more spontaneous and decentralized lending would be restored, with a reduced role of the Fund. Nevertheless, the proposed forwardlooking risk analysis by commercial banks might still be needed to ensure that the tendency in the past either to overlend or to curtail credit abruptly would be avoided in the future.

The suggested approach to dealing with the first category of countries identified by the staff--namely, highly-indebted countries that had made substantial progress in adjusting their economies--seemed broadly appropriate, Mr. Finaish remarked. However, as he understood it, and as several previous speakers apparently believed, the term "highly-indebted" was not meant to encompass the major borrowers alone. If that understanding was correct, it included smaller countries that had large debt burdens and had made substantial progress in adjustment.

It was appropriate for the group of countries that were in an early stage of solving their debt problems to maintain a flexible relationship between their adjustment efforts, financing, and rescheduling until they had made enough progress to make use of the options available to the first category of countries, Mr. Finaish said. He agreed with the staff that the adjustment efforts in those countries would be helped if export cover could be resumed in an orderly fashion, and if the commercial banks maintained a balanced policy regarding their exposure in the debtor countries concerned.

The evolving process of dealing with the debt problem had worked reasonably well on the global level, but had apparently worked better for large debtors than for smaller ones, Mr. Finaish commented. While the reasons for that trend were debatable, it was clear that smaller debtors--many of which were small, low-income African countries--had been unable to achieve satisfactory external positions despite the severe belt tightening measures they had adopted within the framework of Fund-supported programs. Moreover, those countries traditionally had not enjoyed large or steady access to commercial credit and, unlike major debtors, had generally not benefited from an infusion of new money associated with bank financing packages. It was clear that the low-income countries, whose debt problems were expected to continue for some time, were in particular need of greater international attention and additional foreign assistance. The assistance should be in a form that would enable the low-income countries to increase their production of tradeable goods, thereby improving their balance of payments position over the medium and longer run. Of course, those countries would have to maintain and, in some instances, strengthen their adjustment policies; in that connection, the Fund would have a crucial role to play. However, the limited room for additional demand restraint in many of those countries, and the below subsistence levels of income and consumption, suggested that emphasis should be placed on supply-oriented policies that would boost production and halt the rapid decline in living standards, which were already very low.

The staff could have usefully evaluated the effectiveness of the Fund's catalytic role in support of low-income countries' adjustment efforts, Mr. Finaish considered. He recognized the difficulty in judging whether the catalytic role had benefited the low-income debtors, where the Fund's role had frequently been identified as catalytic, as much as it had helped other member countries. Still, some discussion on the matter would have been useful.

Adequate export credit cover clearly played an important role in sustaining orderly adjustment, Mr. Finaish commented. Therefore, greater flexibility in meeting the needs of individual debtors, including the possible participation by export credit agencies in financing packages, could be useful. Moreover, it was in the interest of the export credit agencies to resume cover in a timely fashion for countries that were making an effective adjustment effort.

The comparability of treatment of creditors was an important matter, Mr. Finaish said. The staff had noted the increased emphasis given to that matter by the Paris Club both through the standard comparability provisions and the initiative clauses in Paris Club agreements. He wondered whether the present wording of Paris Club agreements implied that a country negotiating a rescheduling that accorded to a nonparticipating creditor treatment that was less favorable than that accorded to participants would be in violation of its Paris Club agreement; a strict interpretation of the comparability of treatment clause suggested otherwise.

Mr. Dallara noted that following the clear emergence of debt problems two years' previously, a number of global solutions to those problems had been proposed. Some of the proposals involved dramatic departures from traditional financial practices and would have provided generalized debt relief. Those proposals had not been widely favored by either debtors or creditors, and a case-by-case approach had evolved instead. Although that approach was comprehensive and was applied within an established general framework, it had been tailored to the particular circumstances of individual debtor countries. Its basic framework had included economic adjustment by the debtor countries, together with sustained growth and maintenance of open markets by all countries. In addition, a central role had been played by the international institutions, particularly the Fund, whose resources had been significantly strengthened. Perhaps even more important, the overall framework had included the provision of policy advice designed to achieve a resumption of economic growth, continued prudent lending by commercial banks and, in certain cases, bridge financing by monetary and financial authorities in industrial countries.

Progress had been made in all those areas, although when the case-by-case approach had been introduced, skeptics had doubted whether it would provide adequate financial support of adjustment efforts, Mr. Dallara went on. Indeed, that approach had resulted in a much larger volume of financial assistance than most observers had expected. In 1983-84, when many commercial banks had wished to reduce their exposure in a number of developing countries, long-term lending to the indebted developing countries had totaled some $61 billion. Similarly, in the two years through January 1985, the amount of debt covered by official debt relief under the case-by-case approach had totaled approximately $16 billion, even though the creditor governments themselves had faced serious budgetary problems. In the two years through December 1984, $147 billion in the commercial bank debt of 30 countries had been rescheduled. That outcome was the result of close cooperation among debtor and creditor governments and international institutions, particularly the Fund, within the context of the case-by-case approach.

Member countries willing to introduce the necessary measures had generally been able to receive the financial assistance needed to adjust in an orderly fashion, Mr. Dallara commented. As a result, considerable adjustment had indeed been achieved: the external current account deficit of the nonfuel developing countries, which had peaked at about $91 billion in 1981, had fallen to $38 billion in 1984 and was expected to decline slightly in 1985 and 1986. Those aggregate figures masked occasional problems in individual countries, but they also suggested that member countries' future debt burden and financing needs would be smaller than they would have been in the absence of the case-by-case approach and members' adjustment efforts. Moreover, there had been a significant recovery of growth in many of the debtor, as well as creditor, countries. The adjustment efforts by the debtor countries had not been easy, and the persistence many of those countries had shown was impressive. The Executive Board's reviews of Fund-supported adjustment programs had clearly brought to light the difficulties in making needed adjustments and the benefits of persevering in those efforts.

The efforts by creditor countries to mobilize the necessary official support for developing countries' adjustment had often been difficult, Mr. Dallara went on. Many commercial banks had had to take into account the risk of new lending to countries whose creditworthiness had been subject to serious doubts, while banking regulatory authorities had had to balance a number of difficult considerations relating to the quality of banking assets in the immediate and longer term. Moreover, financial authorities had often had difficulty in obtaining legislative authority for additional commitments of bilateral and multilateral resources. On the whole, considerable progress had been made in responding to the debt problem, but perseverance by all the parties concerned in applying the case-by-case approach would be required in the coming period.

The debt problem was only one aspect of each country's overall balance of payments position, which was a reflection of a number of factors, including the authorities' policy stance and the serious difficulties facing the economy, Mr. Dallara commented. The opening statement by the staff at the previous meeting had usefully focused attention on the relevant underlying policy issues. While the present discussion was not the appropriate one at which to conduct a detailed examination of the role of underlying policies, the importance of those policies in both debtor and creditor countries should be underscored.

The low-income developing countries must introduce strong structural adjustment measures to complement their substantial adjustment efforts in other policy areas, Mr. Dallara considered. He recognized the difficulty the Fund had in addressing the needs of low-income countries while adhering to its central role as a source of temporary balance of payments financing. The low-income countries, like other countries, were appropriately being dealt with on a case-by-case basis. In some countries, further Fund policy advise and financial support, albeit in reduced amounts, might well be required. In other countries, enhanced surveillance might help the Fund to continue to play an important advisory role in close collaboration with other institutions, particularly the World Bank.

The growth of commercial bank lending had progressively tapered off since mid-1982, Mr. Dallara noted. Some growth was estimated to have occurred in 1984, and very little growth was projected for 1985 and 1986. While the projections might be somewhat pessimistic and the actual outcome would depend on the speed at which adjustment efforts took hold and creditworthiness was restored, it was prudent to base the Fund's approach to the debt problem on the assumption that the projections were accurate. The banks had gone through difficult times and, together with their regulatory authorities, were anxious to reduce the risk associated with their portfolios. A moderate but regular increase in new credit to countries that were making needed adjustments in their economies was essential for the resumption of growth and the restoration of creditworthiness. Some countries that had substantially improved their external position over the previous several years would require a reduced volume of credit or no new credit for a while. That development should increase creditors' confidence and enable countries to improve their creditworthiness, which they might find valuable to meet contingencies.

As developing countries persevered in their adjustment efforts, observers must guard against the tendency to judge those countries in the light of past developments, rather than of likely future developments, Mr. Dallara said. In certain cases, multiyear rescheduling arrangements by commercial banks could obviously help provide relief for debtor countries with heavy private debt service requirements, thereby increasing confidence in, and providing encouragement to, the overall adjustment process. While commercial banks were of course free to negotiate arrangements with debtors, they should limit multiyear rescheduling arrangements to countries that had solid adjustment records.

Debtor countries that benefited from such arrangements should maintain appropriate economic and financial policies, Mr. Dallara considered. In that connection, enhanced Fund surveillance had already been a factor in the willingness of commercial banks to enter into some multiyear rescheduling arrangement. As the staff had noted, such surveillance could be an important tool in the transition period in which commercial banks began to base their credit decisions on market factors and commercial bank lending regained its usual voluntary nature. At the same time, enhanced surveillance could permit the Fund to continue to be involved in the adjustment process of the countries concerned, thereby bolstering confidence in the countries even without new lending by the Fund. However, it was important to stress that while the Fund's role in enhanced surveillance should be to improve the banking community's understanding of the situation of a particular country, private creditors would have to make their own financing decisions.

Many questions concerning enhanced surveillance would have to be dealt with on other occasions, and such surveillance would have to develop in an evolutionary fashion, Mr. Dallara went on. A major question was the extent to which enhanced surveillance should be related to multiyear rescheduling arrangements by official creditors. There were indications that official creditors hoped that enhanced surveillance would be comprehensive and detailed.

Cofinancing could be a more useful vehicle than hitherto for commercial bank involvement in debtor countries, Mr. Dallara considered. The staff had suggested that commercial banks were interested in shifting their support toward trade finance and project-related loans. The World Bank's expertise in evaluating projects could be an attractive feature for commercial banks interested in project-related loans, and particularly banks that could not match the World Bank's expertise in detailed project evaluation. Commercial banks might be particularly interested in project-related loans because such loans were closely connected to specific assets and because the income generation of those assets compared with other assets might be easier to predict. However, in considering such lending, the World Bank, borrowing countries, and commercial banks should bear in mind the medium-term viability of the projects involved.

One of the reasons for the moderate success of the case-by-case approach to the debt problem was the resistence to suggestions that would have undermined the market-oriented elements of the approach, Mr. Dallara commented. One of the schemes that had appropriately been rejected was interest capitalization. He agreed with the staff that such global schemes could undermine the willingness of commercial banks to continue making new lending available to debtor countries.

The likelihood that commercial banks would approach incremental lending with greater caution in the coming period underscored the need for additional sources of financing, Mr. Dallara continued. No matter how strongly the commercial banks might be encouraged to continue appropriate lending in support of member countries' adjustment efforts, the staff projections of such lending reflected the harsh reality that the banks were likely to remain cautious. Accordingly, the importance attached to policies that could encourage other forms of financing should be carefully considered. Such policies could be a significant part of the strategy for consolidating the gains that had been made in adjustment and in restoring medium-term balance of payments sustainability.

In that connection, foreign direct investment could play a particularly significant role, Mr. Dallara went on. Such investment had tended to be less volatile and had declined less rapidly than borrowing from financial institutions. The economic recovery under way in many developing countries offered considerable opportunities to attract capital, technology, and skills to help developing countries achieve their various objectives. The outlook for capital expenditure in 1985 by foreign affiliates of U.S. companies abroad--particularly in Asia and Latin America--was very encouraging. The preliminary estimates of a survey conducted in December 1984 suggested that there had been a substantially larger increase in capital expenditure by U.S. affiliates than had been indicated by a survey taken earlier in 1984. Those results suggested that there was a considerable potential for foreign direct investment that should be tapped through the adoption of more open policies specifically designed to encourage such investment. The issue of foreign direct investment should certainly be kept in mind when the debt problem was assessed in the coming period.

There were also opportunities to attract portfolio capital, Mr. Dallara went on. Some of those opportunities had been neglected; only a dozen countries had tapped the international bond markets in 1984. It was true that many countries had neither the capacity nor the creditworthiness to use those markets, but that alternative should not be ignored in the medium term, as additional adjustments were made and sources of potential financing in addition to commercial bank lending were explored. Equity investment was another promising financing channel, and the openness of investment policies could provide an important incentive to such investment. U.S. private pension funds had some $16 billion of their portfolio in equity investments abroad, and some of the funds apparently were seeking greater portfolio diversification, including issues traded on emerging capital markets in certain developing countries. The development of some of the newly emerging capital markets in major developing countries could help to attract equity investment, to lower the cost of the investments that were made, and to encourage the repatriation of capital that had been taken out of the developing countries concerned. The prospects for encouraging foreign investment would depend on both the economic developments in debtor countries and the attitudes of their authorities, who should be encouraged to act promptly to provide the needed incentives.

Export credit policies affected the flow of exports as well as the pace of adjustment in developing countries, Mr. Dallara commented. Export credit played a significant role in balance of payments financing and adjustment, although making contributions in those areas was not the primary goal of export credit agencies. Still, there had been a generally constructive gradual change in the policies and attitudes of those agencies. Maintaining or resuming export cover had a significant effect on member countries' overall liquidity position, but it was important to recognize that such credit was not equivalent to general balance of payments financing; Executive Directors should bear that limitation in mind in assessing the role of export cover.

At the same time, Mr. Dallara went on, export credit should be expected to play a significant role in the adjustment effort. It could not only provide additional credit but also could play a major role in mobilizing private sector financing flows, although some practical problems had arisen with that. For example, export credit agencies had occasionally withdrawn their cover just as a country had begun to introduce appropriate adjustment policies, thereby unfortunately sending incorrect signals to the market that might have interrupted trade flows that had significantly supported the adjustment effort. In some cases, export credit agencies had maintained credit excessively long, thereby playing a counterproductive role in the adjustment process, as adjustment measures had been postponed but the cost associated with those measures had been greater when the measures had finally been implemented. Nevertheless, export credit agencies had made contributions both through debt rescheduling and by providing additional cover when other market participants had hesitated to do so. Debtor countries seeking rescheduling arrangements should realize that there was a close link between the terms of debt rescheduling and the provision of new export credit cover. For example, advancing a contract cutoff date in successive reschedulings and unilateral rescheduling of debt could have chilling effects on the provision of new export credit.

Export credit agencies, like commercial banks, were heavily influenced by experience, including a country's performance under a rescheduling agreement, Mr. Dallara remarked. The staff proposals regarding coordinated international arrangements could only be implemented through the drawn-out procedure of establishing a consensus among agencies about borrowers on a country-by-country basis. However, the Export Credits Group of the OECD could play a key role.

Substantial official debt relief had been provided over the previous several years, and creditor groups had adapted their procedures to evolving circumstances in specific countries, Mr. Dallara said. A comparison of the terms and conditions for rescheduling arrangements in 1979-81 with those in 1982-84 clearly showed the considerable increase in the differentiation of treatment of individual creditors, reflecting the growing awareness of official creditor agencies of the need to tailor their response to the particular conditions in individual creditor countries, including the degree of adjustment by each country. At the same time, the terms regarding arrears and previously scheduled debt had been tightened, reflecting the high priority given by creditors to those matters.

Official debt rescheduling must continue to stress the need for nondiscriminatory treatment among official creditors, and the recent full participation in the Paris Club by official bilateral creditors who had not traditionally participated in Paris Club negotiations was welcome, Mr. Dallara said. His authorities also attached importance to the comparability of treatment of official creditors, although they appreciated that such treatment could not be determined in a mechanistic way. The staff had provided technical assistance in the area of comparability in the past and might well be able to continue to do so in the future. However, in the end, only creditors themselves could determine whether or not comparability had been achieved. Due attention should also be given to the relative treatment of public and private sector debtors. In some respects, debt rescheduling arrangements had occasionally given preference to public debt. That practice could cause private borrowers to lose their access to foreign credit; once lost, the access would be difficult to restore. Any attempt at unilateral approaches to official debt rescheduling could be expected to generate strong or counterproductive reactions by creditors. The temptation to undertake unilateral debt rescheduling might be particularly strong in the case of nonguaranteed supplier credits, because of the difficulty in obtaining data and the lack of spokesmen for the various groups of creditors.

Previous speakers had paid considerable attention to multiyear rescheduling arrangements by official creditors, Mr. Dallara noted. Official creditor groups had traditionally been reluctant to accept such arrangements, particularly because of their unfortunate experience with similar techniques. Moreover, the relatively small size of official creditor groups and the simplicity of their procedures had made it possible to respond fairly promptly to debt relief needs on an annual basis, thereby reducing the need for multiyear arrangements. However, the staff had shown that there had been a fairly large number of consecutive arrangements that had resembled multiyear rescheduling. For example, of the nine countries that had had three or more reschedulings since 1975, three had received debt relief over a consolidation period of three or four years. One of those countries had received debt relief over a period of some five consecutive years, and five of the countries had received debt relief over a period of more than five consecutive years. All those countries had been given effective debt relief equivalent to 95-100 percent of the principal and interest falling due. That process had given the countries substantial debt relief in support of their appropriate adjustment efforts. Hence, experience suggested that debt relief could be provided without resorting to formal multiyear rescheduling arrangements. The need for exceptional debt relief must be examined in the light of the debtor country's specific prospects. The fact that some countries had experienced continued payments problems despite having been given extraordinary debt relief showed that such relief alone was not a solution to those problems. Moreover, recent experience had not changed the Paris Club's view that debt relief was meant only to relieve temporary payments problems and not to substitute for concessional development assistance.

At the London Summit in 1984, his authorities had stated that like the authorities of other major industrial countries, they stood ready to negotiate multiyear rescheduling arrangements, Mr. Dallara continued. However, the use of such arrangements should not be widespread, and certain criteria would have to be met if such arrangements were to be finalized. Multiyear rescheduling arrangements provided debt relief in a manner that should encourage the member countries concerned to gradually return to the market place to receive guaranteed and nonguaranteed credit. To be considered for a multiyear rescheduling arrangement, a country should have a good adjustment record, good prospects, and a high projected level of amortization that, in the absence of debt relief, could impede debt servicing despite the country's adjustment efforts. The countries concerned should be expected to adopt comprehensive adjustment programs that would deal adequately with both internal and external disequilibria. In the light of the need to meet those criteria, he did not expect multiyear rescheduling arrangements to be widely resorted to in official debt rescheduling, and it would be premature at present to speculate about the particular countries that would qualify for such rescheduling. There was no specific reason why a country's official creditors or creditor banks would necessarily all agree on a multiyear rescheduling arrangement for the country. The evolution of the Fund's role in supporting adjustment efforts and in enhanced surveillance would significantly affect the evolution of multiyear rescheduling arrangements.

As important as countries' debt problems were, they were merely one of the overall balance of payments difficulties facing many members, Mr. Dallara concluded. In turn, those difficulties were a manifestation of a variety of factors, such as inadequate underlying policies. Considerable experience in dealing with debt problems had been gained over the previous two years. In general, member countries had had greater success in achieving external adjustment than in adjusting domestic policies. In the coming period, attention must be focused on the need for sound underlying economic policies over the medium term in order to deal with the debt, balance of payments, and overall economic problems facing industrial and developing countries.

Mr. Salehkhou commented that the staff's main conclusions gave the impression that the recent improvement in the external positions of many borrowing countries and the relatively smooth process of debt rescheduling vindicated the case-by-case approach favored by the Fund as well as private and official creditors. There were three corollary conclusions: the case-by-case approach should be maintained over the medium term; attempts to seek international or global solutions to the debt crisis would be inconsistent with the aim of restoring normal foreign lending to developing countries; and the contributions to solving the debt problem by the Interim and Development Committees at their forthcoming meeting should be limited to exploring ways to improve the international economic environment and to consolidate the progress achieved thus far.

The staff seemed rather optimistic about the ability of borrowing countries to deal with their debt servicing difficulties over the medium term if the conditions and financing terms of the previous two years were to recur, Mr. Salehkhou went on. The staff had not made a comprehensive assessment of the sources of excessive debt accumulation and the causes of the repayment problems that had threatened the stability of the international monetary system in 1982. Although the debt crisis had been widespread, affecting many developing countries as well as large sectors of the industrial economies--as evidenced by the record number of business failures--the staff had assessed the repayment difficulties facing member countries largely in the context of the specific circumstances of individual member countries. As a result, the staff had overlooked a number of factors that were crucial for an objective assessment both of the sharing of the burden of the debt problems between debtors and creditors and of the viability of the rescue operations undertaken thus far.

Both commercial banks and industrial countries' official financing agencies had played a significant role in the accumulation of external debt by a large number of developing countries, Mr. Salehkhou continued. Intense competition, the desire to make profits, the availability of oil revenue surpluses for recycling, and the need to sustain growth and employment in industrial economies had encouraged international banks to excessively increase their exposure in developing countries. In the second half of 1982, Mexico's difficulty in making scheduled repayments had led the banks to make hasty attempts to reduce their overall exposure in developing countries and to cease lending to a number of borrowers that were essentially solvent. Domestic economic and noneconomic considerations had played a major role in the expansion of credit by official creditors. The competition among government agencies in industrial countries to extend credit and what was essentially covert subsidization. The need to maintain traditional export markets and political influence had also been factors in the expansion of credit. In that connection, the employment situation in creditors' domestic economies had been a particularly significant factor.

The inadequacy of Fund surveillance of major industrial countries had indirectly played a role in the sudden emergence of the debt problem in 1982, Mr. Salehkhou went on. The Fund had failed to persuade those countries to correct fiscal and monetary policies that had caused soaring international interest rates and growing protectionist pressures, thereby adversely affecting debtor countries' capacity to service their external debt.

The burden of adjustment to the debt problem had fallen mostly on debtor countries, as the commercial banks had been able to further raise their profits by greatly increasing interest rate spreads, Mr. Salehkhou noted. At the same time, government agencies had tended to phase out export credit subsidies and to apply market interest rates to rescheduled debts and new transactions. Debtor countries had had to pay exorbitant rescheduling fees in addition to the increased spreads and higher interest rates and, more important, had had to sustain enormous costs in growth, employment, and future developments in order to service their external debt.

Adjustment through significantly curtailed investment and import compression might have helped a number of borrowing countries to improve temporarily their overall balance of payments position and to strengthen somewhat their international reserves, Mr. Salehkhou continued. However, the staff papers did not discuss the long-term costs and sustainability of those strategies, particularly in the light of the long period of negative capital flows to developing countries. The World Bank had recently estimated that the 12 major borrowing countries had recorded negative net transfers of $15 billion in 1984, compared with $10.1 billion in 1983. That trend was particularly unsustainable because governments had recently given a greater priority to continuing to service their external debt than to solving their domestic economic problems.

In the long run, borrowing countries could increase their debt servicing capacity only if they were able to maintain sustainable economic growth and were given access to export markets, Mr. Salehkhou said. Accordingly, there was an urgent need to resume development-oriented policies and to restore positive capital flows on concessionary terms. Borrowing countries were fully entitled to such treatment. It was also necessary to reverse the recent trend of protectionism and to correct major industrial countries' fiscal and monetary policies to stop the renewed rise in interest rates and exchange market disturbances that threatened to undermine the progress that had been achieved through the implementation of adjustment measures.

The appropriateness of alternative approaches to debt servicing difficulties was dismissed in the staff papers, mainly because of the need for a sound international banking system and the experience of repeated reschedulings in 1961-75, Mr. Salehkhou commented. Such experiences indicated that no country required less than two agreements and two years of reschedulings and an average consolidation period of four years, and none of the repeated reschedulers which succeeded in correcting their imbalances had received exceptional rescheduling terms. However, suffice it to say that the period referred to in SM/85/62 bore little resemblance to the present debt situation and did not appear to be a good basis for comparison, mainly because the economic events that shaped the 1961-75 developments were radically different from post-1975 experiences.

While maintaining a sound international banking system was a major factor in the effort to return to spontaneous commercial bank lending and to support the expansion of world trade, there was scope to reduce spreads substantially as well as to eliminate rescheduling fees in order to reduce the burden of adjustment on borrowers and to share that burden among the various parties that had contributed to the excesses of the past, Mr. Salehkhou considered. Moreover, a sound international banking system was not incompatible with a significant increase in assistance by industrial country governments, including concessionary lending, grants, and debt cancellations by government agencies. At the same time, official creditors should agree to multiyear rescheduling agreements with relatively simple provisions and less stringent conditionality along the lines they had been urging commercial banks to approve. Moreover, export credit cover operations should be resumed; the agencies should stress not only the soundness of investment projects but also the usefulness of concessionary assistance.

As to the proposal concerning enhanced surveillance, Mr. Salehkhou said, he had consistently opposed the provision of confidential information to outsiders, especially unofficial bodies. Commercial creditors had a sophisticated network of data collection and need not and should not request information from the Fund or rely upon the Fund as a source of data; information entrusted to the Fund should remain confidential. In any event, there was no need for enhanced surveillance, except in the remote possibility that it could be uniformly applied to all member countries, including major industrial countries, whose policies had global repercussions.

He felt strongly that any rescheduling or other arrangements designed to alleviate or eliminate the plight of debtor countries could not succeed unless due attention was paid to their ability to repay debt, Mr. Salehkhou remarked. Of course, a member country could not be expected to make payments unless it had a viable production base and access to export markets, which, in some cases, might be possible only in the longer run. Meanwhile, a strong case could be made for establishing a direct link betwen rescheduling or new financing terms, such as capitalization of debt service with long maturities on the one hand, and a country's growth, development, and export prospects on the other.

He harbored serious doubts about the sustainability of the so-called case-by-case approach over the medium term, Mr. Salehkhou concluded. There was ample scope for global initiatives to alleviate the adjustment burden on borrowers and to achieve a more equitable sharing of the burden without jeopardizing the prospects for a return to normal relations between debtors and creditors. The debt-related problems discussed in the staff papers had occurred mostly in the major borrowing countries. The problems facing low-income countries, particularly in Africa, including their limited access to international capital markets, had not been fully addressed. The staff's discussion on debt to official creditors underscored the Fund's unequal treatment of participants and nonparticipants in the Paris Club. The Fund should not take sides in implementing policies in the debt area. For example, the practice of releasing Fund resources under stand-by arrangements as soon as the member country concerned settled its arrears with a group of creditors was unsatisfactory, as it gave the country no incentive to seek similar agreements with creditors that were not members of any organized creditor group. Unless the Fund explicitly opposed discriminatory treatment of creditors, it might wrongly give the impression that it approved such treatment.

Mr. Nebbia remarked that for most developing countries, and particularly those in Latin America, debt was a major concern because of its social and political repercussions, as well as its economic ones. He hoped that the present discussion and the coming discussions in the Interim and Development Committees would result in an appropriate assessment of the magnitude of the debt problem and that useful suggestions for handling the problem would be made.

The staff had concluded that the emergence of debt servicing problems in 1982 had been caused by inadequate domestic policies of developing countries, poor external debt management, excessive lending by commercial banks, and adverse unforeseen external developments, Mr. Nebbia continued. In his view, external factors had been the main cause of the deterioration in the debt situation since at least 1980, when most debtor countries had initiated a serious and consistent adjustment effort to eliminate the main imbalances in their domestic economies.

The staff had mentioned that the future access of developing countries to capital markets would depend upon the creditworthiness of those countries and possible changes in the banking environment, Mr. Nebbia went on. The creditworthiness of those countries would depend on their adoption and maintenance of adequate adjustment policies. The restoration of confidence could perhaps encourage a return of flight capital. However, given the close links among various elements of the international economy, the success of developing countries' adjustment policies also depended on actions by developed countries. Recent developments suggested that debtor countries were making the necessary effort but that external factors had continued to adversely affect their chances for substantial success. The major debtor countries in Latin America had become net capital exporters despite their continued weak economic situation and the increasing social and political unrest in those countries. At the same time, their access to export and financial markets had continued to be restrained, thereby posing a threat to their economic recovery and to their ability to service their foreign debt. Such factors as the overvalued currencies of some industrial countries and the record-high real international interest rates had increased the substantial burden on indebted developing countries, and that burden was likely to remain indefinitely.

Although international interest rates had recently declined, the World Economic Outlook papers forecast new increases, Mr. Nebbia noted. The case-by-case approach had helped to solve the debt problems of a number of individual countries. However, the substantial efforts that had been made by the debtor countries to adjust their economies and by creditors to provide needed financing would not constitute a lasting solution to the debt problems if the present external situation were to continue. It was for that reason that a number of countries, including those in his constituency, hoped to reach a political agreement on certain global factors before focusing on the best treatment of individual debtor countries on a case-by-case basis.

During the previous several months, some Latin American countries had formulated external debt rescheduling programs with the support of the international financial community, Mr. Nebbia commented. The terms and conditions of those restructuring operations had constituted an important step forward and should be extended to countries that were currently renegotiating their debt. Nevertheless, debt restructuring in itself merely postponed the need for a lasting solution to overall debt problems. Restructuring negotiations with commercial banks alone did not provide an opportunity to discuss such broad issues as the need for symmetrical adjustment. Debtor countries should continue to make so-called positive adjustments by maintaining fiscal and monetary discipline, but there should be some room for an increase in their imports, so that economic growth could be resumed. The external position of debtor countries could be improved if they were able to increase exports and investment and to record positive economic growth. Moreover, a lasting and stable solution to the external debt problem could not be found unless the governments of the creditor and debtor countries agreed on an appropriate political framework in which to resolve all the outstanding issues in a constructive manner.

Export credit extended or guaranteed by official creditors to developing countries amounted to roughly one fourth of the outstanding external debt of those countries, Mr. Nebbia observed. However, the objectives of official export credit agencies--namely, export promotion, maintenance of financial balance and, occasionally, support for national strategic interests--might not be consistent with the import priorities and other interests of developing countries.

The demand for export credit cover was likely to rise in the near future as a result of the perceived increase in risk owing to the substantial accumulation of external debt in recent years, Mr. Nebbia noted. The demand was also likely to increase because of the projected shift away from general purpose balance of payments financing of developing countries and toward greater reliance on trade and project financing. The export credit agencies should be prepared to increase their exposure in response to the growing demand for their assistance. As a result, governments would have a crucial role to play in avoiding a squeeze on world trade and in promoting a recovery of financial flows to developing countries. Insurance by government agencies was particularly important at a time when the private sector had overestimated the risks in extending credit to developing countries.

The need to engineer a recovery of growth in developing countries called for a high level of investment in those countries, Mr. Nebbia remarked. The need for imports of machinery and equipment should increase sharply, and export credit agencies would have a critical role to play in providing long-term credit. Those agencies were charging unusually high premiums and were applying restrictive supply measures to developing countries that were rescheduling their debt; such policies might undermine the ability of the debtor countries to sustain an economic recovery. In that connection, the most restrictive measures had been applied by agencies that provided medium- and long-term credit. Their actions had worsened the maturity structure and overall external imbalances of debtor developing countries. New funds from export credit agencies had been an element of some of the rescheduling packages in which the Fund had been involved. Careful consideration should be given to maintaining consistency between the funds offered by the export credit agencies of different countries and the import restrictions and adjustment program priorities of the debtor countries.

Progress had been made in increasing the flexibility of official creditors in responding to the rescheduling needs of a large and diverse group of debtor countries, Mr. Nebbia considered. However, official debt relief alone might not be sufficient to enable several of the present debtor countries to achieve sustainable growth and to promote orderly adjustment. The debt servicing problems facing developing countries still posed a threat not only to the prospects for those economies but also to the entire international financial system. Several developing countries continued to face substantial debt servicing problems despite their adjustment efforts, some of which had been made with the support of arrangements with the Fund. Further action was needed to ensure that the financial flows to developing countries were sufficient to enable them to seek orderly adjustment, regain their access to capital markets, and resume economic growth. Accordingly, official creditors should consider the usefulness of multiyear rescheduling in order to help restore confidence in debtor countries' ability to service new debt.

Moreover, Mr. Nebbia went on, debtor countries must have the assurance that their longer-run financial requirements would be met appropriately--namely, through multiyear rescheduling agreements and the availability of an adequate volume of financial assistance. To that end, there was a clear need for adequate and mutually acceptable mechanisms to monitor developments in member countries that did not have an extended arrangement with the Fund. Strict adherence to the principle of linking debt consolidation periods to the conclusion of upper credit tranche arrangements with the Fund could constitute an obstacle to the appropriate timing of rescheduling negotiations and might lengthen the consolidation period.

Mr. Suraisry said that he preferred to group indebted countries according to the degree of successful adjustment and the size of each country's debt in relation to its economy, rather than on the basis of criteria identified by the staff in its opening statement at the previous meeting. Because of the cooperation of all the parties concerned, considerable progress had been made since mid-1982 in solving developing countries' debt servicing problems. However, the results were uneven, and much remained to be done. Additional adjustment was needed to enable debtor countries to restore economic viability and to generate sustainable growth. At the same time, those countries had to be assured that they would receive adequate flows of resources. Accordingly, a coordinated approach, involving the Fund, the World Bank, member countries, commercial banks, and official creditors, was required, and it should be aimed at helping to normalize relations between creditors and debtors and to sustain financial flows to developing countries.

The role of the Fund in ensuring the smooth functioning of the international financial system had been crucial, and would continue to be so, Mr. Suraisry remarked. The cooperation of all the parties concerned was vital if the Fund were to successfully meet its responsibilities. The adoption of effective economic adjustment programs, with or without the support of Fund resources, was a prerequisite for the continued orderly settlement of debt. Enhancing the cooperation between the Fund and member countries was in everyone's best interest. Accordingly, it was important to strengthen surveillance, in general, and surveillance of economic policies of industrial countries. Recent experience fully justified the Fund's emphasis on exchange rate, fiscal, and trade policies in Article IV consultations with industrial countries. More appropriate policies in the major economies would help the debtor countries to solve their debt problems.

The case-by-case approach to handling the adjustment and financing problems facing member countries was sensible and should be continued, Mr. Suraisry considered. Debtor countries must strengthen the resilience of their economies to external shocks by adopting timely and appropriate policies. To that end, diversifying the sources of capital flows to debtor countries was particularly important, and private capital inflows should play a significant role in that effort. In the circumstances, it was appropriate to move away from the crisis management of debt problems and toward a medium-term approach. Debtor countries should be encouraged to move in that direction, and the Fund should stand ready to provide all the necessary assistance so that the members could regain spontaneous access to international credit markets. In that context, multiyear rescheduling arrangements could be helpful. The Fund had been instrumental in the evolution of such arrangements, particularly through its surveillance. However, the Fund should not pass judgment on whether or not bank financing associated with multiyear rescheduling arrangements should be continued; commercial banks themselves should make that judgment. He agreed with the staff that multiyear rescheduling arrangements had been available to countries that had made convincing progress in adjusting their economies.

Commercial banks played a significant role in providing financing to member countries that were introducing needed adjustment measures, Mr. Suraisry continued. The banks had cooperated in the effort to promote orderly adjustment in those countries, and they should continue to do so in the coming period. To that end, it was essential for the banks to strengthen their balance sheets, risk assessment procedures, and overall management. Banks should also appraise the impact of countries' policies on their debt situation and adequately monitor the countries' economies. In that connection, the Fund should continue to stay in the picture. Moreover, efforts to strengthen banks' viability should not be made at the cost of providing adequate debt rescheduling to member countries.

Official creditors had shown flexibility in handling the problems facing debtor countries, Mr. Suraisry said. Governments and their credit agencies had shown great understanding of those problems and had made a positive contribution to enhancing the financial flows to debtor countries. He was confident that official creditors would continue to deal flexibly with indebted countries as long as those countries maintained their adjustment efforts. Whether or not a multiyear official rescheduling agreement was appropriate for a member country depended significantly on the country's debt profile and adjustment effort. Multiyear rescheduling of official credit could help countries that were particularly indebted to official creditors. However, official creditors had no means other than the Fund to help monitor the adjustment efforts of debtor countries that had been permitted to reschedule their official debt on a multiyear basis.

If low-income developing countries, particularly those in Africa, were to make needed adjustments and record positive economic growth, they must receive not only debt relief but also concessional financing, Mr. Suraisry remarked. All the parties concerned must contribute to the effort to ensure that adequate concessional financing would be available. In that connection, the World Bank had a particularly important role to play, for example, in coordinating the concessional flows. There was room for the World Bank to expand its role in that area, provided that the member countries concerned introduced adequate adjustment measures.

Export credit agencies had a useful role to play in providing trade financing to developing countries, Mr. Suraisry went on, and those flows should be maintained in an orderly manner. The export credit agencies and the World Bank should cooperate to facilitate larger credit flows to developing countries and to ensure that the recipient's investment programs were viable.

There was an obvious need to build on the progress made thus far in solving developing countries' debt problems, Mr. Suraisry concluded. In that connection, the Fund had a crucial role to play: it should use its surveillance and catalyst functions to ensure that developing countries introduced needed adjustment measures and received sufficient financing. The effectiveness of the Fund in the coming period would depend upon the continued cooperation of all the parties concerned.

Mr. Clark said that the main objective of international economic policy in recent years had been to restore a stable financial environment after the disruptions and difficulties of the early 1980s. That stability was a necessary condition for the resumption of sustained growth in individual economies and in the world economy as a whole. Significant progress had been made under the so-called case-by-case approach, attributable in no small part to the Fund's efforts. That approach should be maintained. But it was important to re-emphasize that international financial stability depended significantly on the domestic policies of individual developed and developing countries.

The present review was focused on certain aspects of international borrowing and lending, but it was helpful to keep in mind the broader context of financial intermediation as a whole, Mr. Clark considered. He was pleased that all three staff papers were being considered together. Nevertheless, they covered only part of the picture--namely, the offical sector and the commercial banks. His chair had consistently attached considerable importance to encouraging nonbank private capital flows. He recognized that the quantitative contribution of such flows was likely to be small for a while, but there were good reasons to promote them in the longer run. Similarly, it might be helpful to explore further the links between domestic and international financial intermediation, particularly with respect to the commercial banks. After all, international lending still amounted to less than 20 percent of the commercial banks' total assets.

The supply of international credit over the coming several years was likely to be limited, Mr. Clark noted. Accordingly, adjustment policies would have to be firmly sustained. But many member countries had accumulated a level of external debt that it would be unwise for them to increase even if finance were available.

The main objective of each group of debtor countries mentioned in the staff's opening statement at the previous meeting must be to regain a sustainable pattern of finance, Mr. Clark said. The nature of that pattern and the time needed to achieve it were likely to differ for each of the three groups of countries.

For the first group, the highly indebted countries that had made substantial progress in adjusting their economies, the present approach of smoothing out the hump in debt maturities facing some of those countries was fully appropriate, Mr. Clark remarked. That objective could be accomplished through single-year or multiyear arrangements. The key consideration in deciding to move from single-year to multiyear arrangements and to proceeding with a number of other proposals concerning those countries was whether or not the member country concerned was embarked on a policy program that would foster a stable economic environment and thereby justify and complement extended external financing arrangements. Thus, an important issue was how the progress of countries in the first group should be monitored while extended financing arrangements for them were in place. He agreed with previous speakers that the Fund had a key role to play in that process whether through its normal Article IV procedures or its so-called enhanced surveillance. Therefore, there was no reason to require precisely parallel arrangements for official creditors and commercial banks.

There were a number of important issues concerning the nature and time frame of the Fund's involvement in debtor member countries, a major objective of which was the restoration of the debtors' access to credit markets, Mr. Clark continued. However, the Fund was already committed to monitoring arrangements that formally involved it in relations between banks and debtors into the mid-1990s. Management's views on that extended period of the Fund's involvement in those countries would be helpful. As to the commercial banks, they had certainly made progress, with the guidance and prompting of supervisory agencies, in reinforcing their techniques of credit assessment. But the banks still had some way to go, and the Fund's involvement in providing a comprehensive, experienced, and expert--and moreover free--assessment of a country's policy should not discourage the banks from developing their own expertise in that area.

Member countries wishing to reschedule their debt under the Paris Club had almost without exception been required to negotiate an upper credit tranche arrangement with the Fund, Mr. Clark said. However, a number of member countries had rescheduled their bank debt even though they had not had an upper credit tranche arrangement in place. Official creditors might well wish to preserve such differences in considering multiyear reschedulings. While vigorous and closely monitored policies were required, a Fund-supported program need not be in place throughout the debt consolidation period. Instead, it might be appropriate to require a formal program in the early part of the consolidation period with a transition to something like a "classical" stand-by arrangement--under which the Fund's resources would not be used unless necessary--or a shadow program in the later parts of the consolidation. Such procedures were being discussed in the Paris Club.

The problems facing countries that were still at an early stage in resolving their debt-servicing difficulties could be best tackled in the context of adjustment programs implemented under the Fund's guidance, Mr. Clark considered. As to the countries that continued to experience protracted debt-servicing difficulties, he agreed with the staff that the Fund's principal contribution was to provide advice and guidance as well as to engage aid and financial support from non-Fund sources, rather than to provide Fund financing, whose terms were often inappropriate for the countries concerned.

Scope existed for greater policy coordination in decisions to withdraw or reinstate export credit cover, although absolutely uniform behavior of the sources of such cover was undesirable, Mr. Clark considered. In any event, such uniformity probably could not be achieved, given the different positions and mix of business of the various export credit agencies. There was also a risk of instilling too strong a "herd" instinct, which could be unhelpful. The World Bank's involvement in investment project appraisal as a possible means of encouraging restoration of cover to countries that were emerging from a period of debt difficulties was welcome. There was no automatic or rigid link between multiyear rescheduling arrangements and reinstatement of export credit cover; account should be taken of a much broader range of factors that certainly overlapped with those involved in a MYRA but were not necessarily entirely coincident.

Commercial banks should improve their own risk assessment efforts, Mr. Clark said. They should also continue strengthening their capital base and adopt more general measures to increase their resilience to exogenous shocks.

It would be interesting to examine outstanding stocks of assets and liabilities in addition to the flows of new lending, Mr. Clark considered. A first objective might be to determine how the present level of debt and intermediation in the world economy stood in relation to past levels. A simple extrapolation of previous trends would not of course give a good indication of the sustainable level of intermediation in the coming period. However, it would be interesting to know the extent to which present levels of debt exceeded those not just of the mid-1970s reported in the staff paper, but of the 1960s and early 1970s as well; that analysis might encompass domestic debt in the major economies as well as external debt. It would also be helpful to consider what might be a robust and sustainable pattern of financial flows to developing countries in the longer run including, in particular, the appropriate contribution of the banks, official lenders, the private sector, aid, and the multilateral agencies.

Mr. Ortiz said that the staff papers contained considerable information and significant analytical insights but did not provide a unifying conceptual framework needed to gain a proper perspective on the debt problem. The paper on commercial bank debt included a discussion of developments leading to the present debt situation and analyzed the steps that had been taken to solve debt-servicing problems, but it did not include an analysis of borrowing countries' adjustment efforts that was essential for evaluating the overall debt problem. In addition, the staff papers highlighted the key policy issues concerning developing countries' future access to financial markets but did not include an evaluation of the possible adequacy of that access. Such an evaluation would admittedly have required a full discussion of possible scenarios on world economic activity in general, and of creditor country policies in particular, an analysis that was an integral part of the World Economic Outlook exercise. Accordingly, it might have been preferable to hold the present discussion on debt after the next World Economic Outlook discussions. Further consideration of debt issues would probably take place during those discussions.

The conclusions reached at the previous Interim Committee meeting clearly illustrated the attitude of some industrial countries toward the various debt issues and provided an insight into their future policies, Mr. Ortiz remarked. Apparently creditor countries believed that the world was heading toward a solution of the debt problem facing an important group of developing countries. Moreover, the concerted lending strategy used thus far--which combined official or quasi-official temporary financing and persuasion of commercial banks to provide the minimum financing necessary to implement adjustment programs with the adjustment efforts of debtor countries--appeared to have worked very well.

Despite the drastic decline in commercial bank lending to debtor countries, creditors apparently would not agree either to global schemes to lighten the debt service burden of developing countries, or to a general subsidy mechanism, Mr. Ortiz noted. Moreover, creditor countries were clearly reluctant both to provide meaningful increases in concessional financing and to strengthen substantially the financial position of international organizations, such as the World Bank and the Fund. Apparently creditor countries wished to continue dealing with the debt problem on a case-by-case basis, to avoid implementing global schemes, and to rely mainly on adjustment efforts by debtor countries to handle the debt difficulties facing individual countries. From the creditors' viewpoint, that approach obviously was sensible; the greater the adjustment efforts by debtor countries and the larger their external surpluses, the smaller the potential transfer of real resources from creditor to debtor countries, if, indeed, any such transfer occurred.

The international community had shown considerable capacity to respond flexibly to the 1982 financial crisis, Mr. Ortiz considered. The Fund had played a leading role in containing the crisis and in establishing effective procedures for borrowing countries to cope with the initial stages of the adjustment process. It was true that the debt situation and the implication of a debt service burden varied from one country to the next, thereby posing difficulties in implementing global solutions to the debt problem. Moreover, the so-called concerted lending packages admittedly could not be a permanent feature of international financial arrangements, and a return to normal relationships between creditors and debtors should be sought. Indeed, Mexico was the first country to reach an agreement with its creditors and to establish the basis for a multiyear restructuring arrangement.

Despite the initial success in dealing with the problem caused by the enormous increase in the external debt of many developing countries during the late 1970s and early 1980s, the situation in borrowing countries--even those that had introduced drastic adjustment measures--clearly remained serious, Mr. Ortiz continued. He was worried that because a major international financial crisis had been avoided and a framework for restoring normal conditions in international credit markets had been established, some developed countries did not fully recognize the costs incurred by borrowing countries that had made adjustment efforts during the previous two years. Indeed, those costs had been much greater than had been originally expected, and the results of the stabilization efforts had been mixed: in general, the strengthening of the balance of payments of major borrowers had been much more rapid than had been expected, while less progress had been made in reducing inflation and in achieving exchange rate stability.

The costs incurred thus far by borrowing countries that had made stabilization efforts directly affected the prospects for their economies in the coming years, as the room to continue adjustment efforts--which might well involve further reductions in consumption--had significantly narrowed, Mr. Ortiz went on. That conclusion underscored the crucial role of access to finance over the medium term in ensuring that debtor countries would avoid a new crisis that would certainly have more severe repercussions than the developments in 1982.

The staff had concluded that the continued lending by banks to member countries in the late 1970s and early 1980s despite the dubious viability of some of the borrowers' economic policies reflected the banks' substantial underestimation of the risks involved, Mr. Ortiz commented. As a result, the banks' portfolios were not very diversified; there had been a concentration of risk on individual loans in developing countries. The provision of public guarantees and the inclusion of cross-default clauses had in effect prevented both a careful evaluation of individual projects by lending institutions and pricing of loans according to perceived risk. As a result, the institutional development of credit markets had effectively prevented consideration of project-related risk factors and careful assessment of alternative uses of resources.

Commercial banks had sought to adjust and upgrade their portfolios by substantially reducing the flow of credit to developing countries and by increasing capital in relation to earning assets, Mr. Ortiz continued. In adjusting their portfolios, commercial banks had divided the market into distinct segments. The first was composed of the major borrowers for which debt restructuring and new money had been made available through concerted arrangements. In that connection, the latest developments included the establishment of multiyear restructuring arrangements designed to give the countries a feasible debt amortization profile in order to facilitate the restoration of normal relations between the debtor countries and their creditors. The second group of countries, which accounted for a smaller proportion of banks' portfolio shares, were deemed to be at an early stage of adjustment. Commercial banks had sought to maintain links with those countries on a year-to-year basis through arrangements for debt relief as well as new financing and Fund-supported programs. For the third group--namely, member countries with structural debt-service problems--commercial banks had occasionally provided substantial relief and de facto rescheduling, although virtually no new money had been made available. That group included some of the poorer developing countries, and he wondered whether the staff had discerned a trend of reduced exposure in those countries by commercial banks. Apparently concerted lending operations and MYRAs were means by which the commercial banks were seeking to reduce their overall exposure to developing countries, and the largest reductions involved the poorest countries and those with the smallest foreign debt in absolute terms.

Multiyear rescheduling arrangements were meant to help restore normal relations between debtors and creditors, Mr. Ortiz remarked. Such arrangements were to replace the concerted lending approach of the previous two years with spontaneous lending by commercial banks. A key feature of those arrangements agreed to thus far was the commitment of the debtor countries concerned to undertake to repay initial debt amortizations and to curtail sharply requests for new money from the banking community in the early stages of the arrangements. He wondered whether banks' efforts to adjust their portfolios were consistent with the efforts of debtor countries to meet their need for balance of payments financing. In other words, would the banks' reduced exposure to borrowing countries be consistent with the resumption of growth in major borrowers, so that normal market relationships could be re-established and further concerted lending operations would become unnecessary?

Apparently the portfolio adjustments by commercial banks were asymmetrical, Mr. Ortiz commented: banks were attempting to reduce their exposure to developing countries, but they were also actively seeking deposits from residents of those countries, thereby further complicating the servicing of the debt by those countries. He wondered whether the staff had estimated the proportion of the recent increase in commercial bank deposits from developing countries that were accounted for by official institutions--and therefore by an increase in the reserves of those countries--and the proportion represented by deposits from nonofficial sources, possibly reflecting capital flight.

The staff had suggested that a MYRA for a country that was not using Fund resources should provide for so-called enhanced Article IV consultations, Mr. Ortiz noted. On page 18 of SM/85/61, the staff had mentioned that "Fund evaluations of countries' policies would assist banks toward making decisions on a market basis.... However, it would be incompatible with progress in that direction for the Fund to provide 'on-off' signals about the appropriateness of further bank lending or of continuing restructuring." A delicate balance must be struck between the need for enhanced consultations and the desirability of avoiding sending the "on-off" signals the staff had described. He wondered whether the staff suggestions would not cause the Fund to take on a new role as a risk and credit evaluator for commercial banks, and he was worried that conflicts might arise between the achievement of the Fund's objectives, and the maintenance of appropriate relations with member countries and the banking community. In his view, the Fund should not play such a role.

Greater flexibility in the treatment of different official debt situations was called for, Mr. Ortiz considered. The negotiations involving some of the countries in his constituency and the Paris Club had been more difficult and lengthy than those undertaken with commercial banks. That development was worrying, because the role of official agencies in providing financial flows to borrowing countries was particularly important, given the drastic reduction in private flows. At the same time, official creditors had required a broad variety of rescheduling terms and conditions. In so doing, official creditors had segmented the market to an even greater extent than commercial banks.

Moreover, Mr. Ortiz went on, the system of rewards used by official creditors had been considerably different from that used by commercial banks. The staff had noted on page 2 of SM/85/62 that the coverage of the rescheduling arrangements for two Eastern European countries and Mexico had been narrower than the coverage of the usual arrangements of official creditors, while the maturity period had been shorter than average. In addition, during the Paris Club negotiations on Mexico's debt, several countries had insisted that the Mexican Government should assume the risk connected with private debt. Although commercial banks had made the same request, the Mexican authorities had stated that it directly contradicted the objective of Fund-supported programs and the wishes of many individual Fund members to strengthen the role of the private sector. Extending a posteriori guarantees on private debt would threaten the very survival of the private sector in borrowing countries. That problem had not been dealt with in the staff papers.

The staff's analysis of export credit cover was particularly helpful, Mr. Ortiz said. He agreed with the staff that the scope for action by governments and their agencies could be increased. Establishing a reasonable framework for multiyear restructuring arrangements was a necessary condition for the restoration of normal debtor/creditor relations and for using the market approach to the solution of some of the problems associated with the external indebtedness of developing countries.

Mr. de Maulde agreed with Mr. Sengupta and Mr. Schneider that the issues under discussion were clearly related to other matters--particularly the World Economic Outlook--that would be discussed by the Interim Committee at its coming meeting. Mr. Schneider had usefully stressed that an improvement in the ratio of debt to exports was a precondition for solving the so-called debt problem, which had seemed to be intractable in 1981-82 because of the very high interest rates and the extremely low demand for imports by industrial countries. Conditions had subsequently improved, and the main question at hand was what the Fund could do to make those conditions last. In that connection, he had recently suggested that SDR allocations would help to consolidate the world economic recovery. The kinds of technical tools discussed by the staff in the various papers could have only a limited effect on the debt problem, particularly if the world economic situation were still difficult.

The substantive issues raised in the various staff papers could usefully be assessed in the context of the Fund's main interests--namely, adjustment and financing, Mr. de Maulde said. The Fund's skills in the area of adjustment were widely recognized by commercial banks, the Paris Club, and export credit agencies. An adjustment program supported by the Fund was generally seen to be the first, indispensable step toward the restoration of a country's creditworthiness and financial equilibrium. However, the Fund itself must recognize that some of its analysis in the adjustment area was rather rudimentary, that some Fund-supported programs had clearly failed, and that the success of other programs was fragile, particularly those in countries with unsustainable inflation rates. Nevertheless, outsiders believed that the Fund had in effect cornered the adjustment business and that since adjustment generated export surpluses, no debtor country could do without it.

He fully agreed with previous speakers on the need to maintain and consolidate the links between Fund-supported programs and the efforts of other creditors to support debtor countries, Mr. de Maulde continued. As Mr. Joyce had indicated, a discussion on enhanced surveillance was overdue, but he doubted whether the suggested semiannual monitoring arrangements would be effective. He wondered whether the directness that had traditionally characterized staff reports could be maintained if future reports were to be circulated broadly.

Mr. Rye's comments on the lack of contact between the Paris Club and the Fund was surprising, Mr. de Maulde said. Indeed, there had been a number of complaints about the excessively close relationship between them. He agreed with Mr. Grosche that multiyear rescheduling arrangements by official creditors in the framework of the Paris Club would be helpful and that establishing credible conditionality would be the main practical difficulty in formulating such arrangements. The Fund could help by encouraging debtor countries to implement multiyear programs; as Mr. Clark had suggested, there might be a number of techniques for ensuring that debtor countries could benefit from rescheduling arrangements while adhering to precise economic and financial criteria.

Efforts should be made to permit export credit agencies to play a larger role in the Fund's efforts to support the adjustment process, Mr. de Maulde considered. The flexibility of each agency's policies should be preserved; it would be impossible to introduce a set of rigid rules and regulations for all agencies. However, a Fund-supported adjustment program in a member country should be actively supported by the local agency. The French export credit agency had strongly supported the Mexican and Brazilian adjustment programs. He agreed with the staff that debtor countries could usefully be provided better information on the ground rules of export credit agencies.

The restricted nature of the suggestions concerning the role of Fund financing in supporting member countries' adjustment programs was inconsistent with the extensive role the Fund aimed to play in the adjustment area, Mr. de Maulde commented. The Fund could not hope to encourage members to increase their adjustment effort while it was reducing the volume of resources it was willing to make available in support of those efforts. Moreover, the Fund could not expect other sources of financing to make more of their resources available to support adjustment when the Fund itself was unwilling to increase its contribution.

He doubted whether so-called enhanced surveillance would be helpful for highly indebted countries that had made substantial progress in adjusting their economies, Mr. de Maulde went on. It would be difficult to negotiate a series of full-scale adjustment programs with those countries, mainly because they had already used substantial amounts of Fund resources and were at or close to their access limits. Accordingly, those countries could benefit most from the Fund's catalytic role; the Fund could negotiate a series of new arrangements for symbolic amounts of Fund resources that would be less than the amount of repayments due to the Fund in the period of the new arrangements. The arrangements would give a clear signal to the commercial banks and official creditors, thereby facilitating the restoration of normal access to capital markets.

On the whole, the Fund, the commercial banks, and official creditors were proceeding appropriately in handling member countries that were at an early stage in solving their debt difficulties, Mr. de Maulde said. However, the approach to handling the poorest countries, most of which were located in sub-Saharan Africa, was unsatisfactory. Those countries were not in a position to rely on their own resources to support strong adjustment efforts, and accordingly, the World Bank had introduced the Special Facility for Sub-Saharan Africa. The provision of financing under the Special Facility would be conditional upon the implementation of far-reaching programs of policy reform. Commercial banks had withdrawn from sub-Saharan Africa and were unlikely to return with any significant assistance in the near future. Moreover, sub-Saharan African countries had no access to private capital markets and would probably have to continue to do without it for some time. As a result, the burden of financing those countries' adjustment efforts fell largely on bilateral donors and international agencies. The Fund's expertise in analyzing member countries' adjustment programs was certainly appreciated, but the Fund's role in helping sub-Saharan African countries should not be limited to catalyzing financing. Other sources of financing would not wish to finance both a member country's development needs and the country's repurchases in respect of Fund purchases. The Fund's unwillingness to make a significant contribution to a financing package for an individual country could cause other creditors to abandon the financing effort, thereby leading the member country to set aside its adjustment program and increasing the chances that the Fund itself would not receive scheduled repayments by that member.

The World Bank should play a larger role--particularly through cofinancing and the provision of guarantees--in helping debtor countries to regain access to private capital markets, Mr. de Maulde stated. The World Bank, and particularly the IFC, could play an important role in promoting direct investment in former debtor countries. He strongly agreed with Mr. Kafka's comments on the need to stimulate domestic savings in developing countries; in that connection, the World Bank's expertise could be helpful. Broader cooperation between the Fund and the World Bank would also be useful.

Approval of the positions he favored would involve a larger increase in Fund financing than some Executive Directors might wish, Mr. de Maulde remarked. That conclusion suggested that access policy should be considered not merely in theoretical terms, but in the broad context of the overall economic situation and of the evolution of the so-called debt problem.

Mr. Polak said that the case-by-case approach to the debt problem had clearly been vindicated. He agreed with the statement in a recent World Bank document that "it has been evolutionary and adaptable in the best of the learning-by-doing traditions, maintaining the flexibility required of the financial system as it adapts to the needs of lenders and borrowers." Nevertheless, it must be acknowledged that the improvements in adjusting countries had been due to a considerable degree to the recovery in industrial countries in general, and the substantial upturn in the U.S. economy in particular.

The various scenarios showed that in the medium term there would be markedly different demands on, and arrangements concerning, the various parties involved in international capital flows, Mr. Polak continued. The baseline scenario showed that real GDP growth in the major debtor countries in 1987-90 would be sufficient--5 percent per year--to resume positive per capita growth. However, the scenario based on the "worst policies in industrial countries" suggested that the growth rate for those countries would be just 1.7 percent, which would imply a deterioration in the living standards of the major debtor countries.

In the circumstances, it would be important to maintain the basic cooperative attitude that had guided all the parties involved in the difficult phase just completed, Mr. Polak went on. It should be clear to all concerned that if and when international conditions should worsen, the Fund should once again stand ready to support countries in the arduous process of making needed adjustments and striving to regain creditworthiness. He agreed with the staff that in those circumstances a return to concerted lending would be the most desirable response.

Developments under the baseline scenarios should include scope for a resumption of economic growth and the normalization of relations between debtor countries and their creditors, Mr. Polak continued. Such developments would give an added impetus to development, and there were a number of means by which they could be facilitated. Restoring normal creditor/debtor relations was crucially dependent upon strong commitments of indebted countries to appropriate domestic and external adjustment policies. Indeed, such policies would help to attract official development assistance and foreign direct investment as well as the return of flight capital; in recent years, capital flight had seriously aggravated the financing problems facing developing countries, particularly those in the Western Hemisphere. Enhanced surveillance by, and arrangements with, the Fund also had an important role to play in restoring normal creditor/debtor relations. He agreed with the staff that, in general, the Fund should move away from actively providing "on and off" signals to other lenders. However, the Fund should stand ready to step in with its traditional arrangements when a member country's situation required it--for example, when a country faced external problems or was experiencing slippages in the implementation of domestic adjustment policies.

Non-Fund creditors should clearly understand the temporary character of the use of Fund resources in support of efforts to restore normal creditor/debtor relations, Mr. Polak went on. Accordingly, commercial banks' positions under a multiyear rescheduling arrangement should be unwound over a much longer period than the Fund's position under a stand-by or extended arrangement. Moreover, it should also be clearly understood that a return to normal debtor/creditor relations implied the termination of "unspontaneous" lending--which had amounted to $23 billion in 1983-84--and the Fund's delicate role in that lending. As normal relations were restored, commercial banks must make lending decisions on their own, and the responsibility for their doing so in an acceptable manner rested with national bank supervisors. Banks could of course use the Fund's published information in making their own lending decisions, and they could informally contact the Fund and national supervisory authorities to receive additional indications of developments in borrowing countries without breaching the confidentiality between the Fund and its member countries. There might also be some scope for an increase in contacts between the Fund and national supervisory authorities.

A number of countries continued to face protracted debt service problems, Mr. Polak noted. That conclusion was particularly applicable to sub-Saharan Africa, where the Fund should seek to play an acceptable and appropriate role in the context of the comprehensive Program of Action adopted by the World Bank for that region; formulating a role for the Fund in sub-Saharan Africa was one of the major challenges in the area of Fund/World Bank cooperation. In addition, commercial banks should treat sub-Saharan African countries in a more flexible manner. Indeed, the same conclusion was applicable to middle-income primary commodity exporters, which had no need for concessional assistance but clearly required sufficient time to make needed adjustments. Creditors, including the Fund, would have to show flexibility and patience in dealing with such countries, even though the magnitude of their debt problems did not pose a threat to the banking system.

Another important topic was the catalytic role that official creditors could play through cofinancing and export credit cover policies, Mr. Polak continued. The latest G-7 communiqué had given the impression that a multiyear rescheduling arrangement involving official creditors was an indispensable step in the process of normalizing the relations between debtors and creditors. As the staff had shown, however, that conclusion was not applicable in all cases; a debtor country might benefit more from a resumption of export credits than from rescheduling past credits. Each debtor country must be able to determine the best way to handle its debt problem.

Debtor countries were aware that under certain conditions they could approach the Paris Club for a multiyear rescheduling arrangement, but there was no forum in which they could even discuss the alternative of seeking a resumption of export credits, Mr. Polak continued. There seemed to be no room for taking initiatives to revive export credit, and export credit agencies seemed reluctant to resume the spontaneous granting of credits or to provide cover to countries that had improved their debt servicing capability. Their reluctance was understandable, but it could lengthen the difficult transition period in which a country attempted to restore its creditworthiness. The World Bank had recently noted that some major export credit agencies had shown interest in internationally coordinated efforts to revive export credit flows. Suggestions for restoring those flows raised delicate issues concerning commercial banks, which might well wonder about the burden sharing involved. If a member country was unlikely to be able to regain access to export credit, or was likely to be able to do so only after a lengthy period, consideration should be given to multiyear rescheduling arrangements--or other arrangements with similar effects--for debt to official creditors of countries whose repayment hump impeded a return to normal relations with its creditors. Steps should be taken to clarify the appropriate role of the Fund under multiyear rescheduling arrangements or similar arrangements.

Because some countries had begun to solve their debt problems and others continued to have access to commercial banks and export credits, it was appropriate to consider how to keep capital flows within prudent bounds, Mr. Polak commented. In that connection, governments had an important role to play both in assuming risks associated with private capital flows--as already occurred in the case of export credits--and as part of their general responsibility for the banking system. Accordingly, a stricter position on the appropriateness of private flows would be inevitable if governments wished to avoid a recurrence of debt problems. To that end, there should be more effective screening of credit by export credit agencies and greater supervision by regulatory authorities of international banking flows. In addition, guidance by the BIS could play an important role in preventing undesirable developments, such as excessive credit flows to one or more particular countries.

The Director of the Exchange and Trade Relations Department commented that the Fund had a close relationship with the Paris Club. It was however clearly understood that the Fund was not to position itself as an interpreter of the Club's views for borrowing countries; member countries should properly seek such advice directly from the Paris Club. The Fund and the World Bank could however play an important role in helping borrowing countries to gain a better understanding of possible means of regaining access to export credit cover; that role would have to be examined carefully and could be expected to evolve only slowly.

Commercial banks had made a commendable effort, through advisory committees, to maintain a cohesive approach in dealing with individual debtors, the Director commented. Advisory committees had played an indispensable role in maintaining order in the system. However, commercial banks had occasionally imposed large fees and difficult conditions on borrowers and had sometimes required public guarantees of private sector credits, thereby overburdening the government and undermining the free operation of the private sector.

In general, the Fund's role in debt problems was that of a mediator and catalyst, the Director noted. Enhanced surveillance was part of the Fund's response to debt problems, and one of its main objectives was to ensure an adequate flow of information, so that market participants could make well-informed decisions. The staff hoped that the period in which enhanced surveillance would be required would be fairly short.

The staff continued to believe that, in seeking debt relief, debtors should give equal treatment to all creditors, whether or not they participated in the Paris Club, the Director of the Exchange and Trade Relations Department said. Finally, the treatment of private sector debt, without a government guarantee, had raised important and difficult questions in the context of both bank and official debt reschedulings. The staff intended to study the question.

The staff representative from the Exchange and Trade Relations Department remarked that the staff had received requests from member countries on possible approaches to the difficult practical problems of rescheduling nonguaranteed suppliers' credits. The historical information on that topic provided in the staff papers was a partial response to those requests. The problem was particularly acute in some African countries, and some of the past techniques for handling the problems mentioned in the staff paper might well be useful in those countries.

The main criterion used by the staff for considering a country included in the group of highly indebted countries was the ratio of debt to GDP or exports, not the absolute level of debt, the staff representative explained.

As the staff understood it, the Paris Club carefully considered whether creditors that had not participated in Paris Club reschedulings gave a debtor treatment comparable with that given by Club participants, the staff representative went on. Apparently the Paris Club's decision on the rescheduling terms for a member seeking subsequent reschedulings had sometimes been influenced by its conclusions about the treatment of the member by nonparticipating official creditors. In some cases, when the Paris Club was aware that an important creditor was not participating in the Paris Club's arrangements for a particular member country, the Club participants had sought assurance that the nonparticipating creditor would grant broadly comparable debt relief.

Concerning the assumption by the debtor government of the commercial risk for private sector debt, the staff understood that, as a rule, when negotiating a bilateral agreement implementing a Paris Club rescheduling for a debtor country, Paris Club participants inquired whether private debtors in the borrowing country were capable of providing local currency to the central bank to discharge their debt service obligations, the staff representative remarked. If the debtor government and its creditors agreed that a private borrower was insolvent, the guarantee that had been extended by the export credit agency would have to be honored, and the agency would have to indemnify the exporter.

It was difficult to say what the chances were that export credit cover extended by export credit agencies could substitute for multiyear rescheduling of official debt, the staff representative said. Creditor governments had begun to increase their exchange of information, and the OECD group on export credits and guarantees had recently begun to exchange information on borrowing countries. The exchange of information was not designed to lead to uniform behavior by the export credit agencies. The agencies had shown some interest in making new export credits available each according to its own standards; they attached considerable importance to having borrowers make effective use of such credits. They were also interested in the screening arrangements for projects that might be adopted by borrowing countries, and they would probably look to the World Bank for assistance. There were signs that access to medium- and longer-term credits extended or ensured by export credit agencies was becoming available to borrowers that had appreciably reduced their external current account deficits. The move in that direction was gradual; in a number of instances, an important export credit agency took the initiative to provide new credit or guarantees, and other agencies might or might not follow its example. The agencies concerned were interested in continuing to consult the Fund and World Bank staffs, and the exchange of information in the OECD group on export credits was expected to continue.

Another staff representative from the Exchange and Trade Relations Department said that it was difficult to trace the trend in capital flight. There had been considerable deposit-taking from non-oil developing countries by commercial banks during 1983 and 1984. A growing proportion of those deposits appeared to have been accounted for by official reserves. The latest World Economic Outlook paper suggested that there had been a significant decrease in capital flight from non-oil developing countries in 1984.

The staff did not believe that commercial banks wished to reduce their exposure to developing countries in absolute terms, but apparently they did wish to reduce their exposure relative to capital and other assets, the staff representative said. The data suggested that there might have been a decline in exposure in absolute terms in sub-Saharan Africa, but the data should be interpreted with caution, as they had not been adjusted for exchange rate changes. The staff scenario suggested that in the medium term international banks' exposure to developing countries in general, and to the major borrowers in particular, might fall back to the level, relative to capital, that prevailed in the late 1970s.

Over the previous year, commercial banks had shown some preference to provide "new money" in the form of trade credit, the staff representative said. That development was a positive one, as it was a signal of the banks' willingness to re-establish normal relations with borrowers. At the same time, the staff had noted that trade financing could not substitute fully for general balance of payments financing.

As the staff had stressed, the advantages for a debtor country of redenominating its existing loans in its domestic currency were difficult to estimate because of the uncertainty about movements in exchange rates and interest rates, the staff representative said. That uncertainty probably explained why some debtor countries preferred to schedule currency redenomination over an extended period; for example, Mexico had recently chosen a period of 42 months. Commercial banks had sometimes required currency redenomination partly as a safeguard against fluctuations in the value of the U.S. dollar. Recent movements in exchange rates--notably, the further appreciation of the U.S. dollar--had apparently made both borrowers and lenders somewhat less keen to use that option. The impact on exchange markets of currency redenomination was complex. Redenomination was merely a book entry. The important factor was the extent to which the rescheduling country decided to change the pattern of its reserve holdings and, correspondingly, the extent to which the lending banks decided to adjust their funding; the general hope was that the two movements would be roughly symmetrical. In any event, the flows involved were moderate and stretched over long periods.

It had been suggested that the staff should keep a wary eye on capital market innovations, and the staff intended to explore the matter in its next paper on capital market developments, the staff representative from the Exchange and Trade Relations Department said. Information provided by the OECD suggested that some developing countries--for example, Turkey, Malaysia, and Indonesia--had been considering the use of market innovations such as note issuance facilities to obtain credits on more favorable terms.

The Chairman made the following concluding remarks:

General remarks

In their overall assessment of the present situation in indebted countries and of policy objectives for the period ahead, Executive Directors agreed that encouraging progress has been made in managing developing countries' debt servicing difficulties. But they cautioned against complacency, noting that the debt problems in some countries have not yet been solved.

The clear progress over the past 2 1/2 years has been due to major adjustments by debtor countries and to concerted action by debtors and creditors, and it has undoubtedly been helped considerably by the strength of the economic recovery, and particularly by the upturn in the U.S. economy. However, Directors noted that the progress of individual countries in restoring a viable payments position and real growth has been uneven. Directors stressed that balanced growth of the world economy, open trading systems, appropriate adjustment policies by the debtor countries, and continued collaboration between debtors and creditors are the keys to solving external debt problems.

Appropriate adjustment policies in debtor countries are clearly needed to foster what Directors called the normalization of debtor-creditor relationships, which in turn would encourage the restoration of debtors' creditworthiness, greater spontaneous bank lending, official credit flows, and official development assistance. In this connection, several Directors underscored the serious nature of the many problems facing sub-Saharan African countries. A number of Directors also stressed that adjustment policies could pave the way for a return of flight capital and for an increase in direct foreign investment and related nondebt-creating flows and transfers of technology.

Several Directors, however, expressed their concern about the social and human costs of the adjustment efforts in developing countries. In their view, the costs were not stressed sufficiently in the staff papers. They thought that greater emphasis should be placed on mobilizing additional financing, especially official development assistance, in order to strengthen the growth potential of debtor countries, especially low-income countries, which have very limited resources or access to bank credit. Those Directors noted in particular the low level of bank lending to debtor countries in the recent past and the additional debt servicing burden due to high real international interest rates, the present trends in the exchange markets, and the effect of protectionism in a number of industrial countries.

Executive Directors generally observed that the progress in reducing debt servicing difficulties could be endangered by adverse developments in the world economy, particularly developments in trade, interest rates, and exchange rates. Directors stressed that appropriate policies in major industrial countries could greatly reduce this danger. In this connection, a number of Directors, noting that policy responses to adverse developments would of course have to be made by both industrial and developing countries--in close collaboration with financial institutions--reiterated the importance they attach to effective and evenhanded Fund surveillance.

Directors commented favorably on commercial banks' readiness to enter into multiyear restructuring arrangements (MYRAs) for certain countries that have made significant progress in correcting the imbalances in their economies. They thought that MYRAs could play a useful role in facilitating a return to more normal capital market access by removing the "hump" in future amortization payments. The ability of the countries concerned to forgo concerted lending would help to set the stage for normalizing creditor-debtor relationships. A number of Directors urged official creditors also to agree to multiyear rescheduling.

Directors agreed that countries at an early stage in solving their payments problems needed to maintain comprehensive and convincing adjustment efforts, supported by Fund arrangements where appropriate. Financial flows, including debt relief and concerted lending, should be tailored to each country's prospects and adjustment effort. A number of Directors considered that smaller and medium-sized countries making strong adjustment efforts must be given the same close and active attention by creditor countries and institutions as countries having greater influence on international economic and financial developments. Some Directors emphasized the need to ensure that financial flows would be sufficient to finance not only immediate balance of payments gaps, but also growth and development. In that context, the roles of official development assistance and cofinancing through the World Bank were stressed. Directors observed that banks and official creditors might need to be flexible, perhaps within a longer-term framework, in dealing with the problems of countries experiencing severe and protracted debt servicing difficulties, especially low-income countries, which generally have little or no access to commercial lending and depend heavily on development assistance. Several Directors emphasized that, as a monetary institution, the Fund should limit its role in those low-income countries to that of a catalyst, providing advice on adjustment that was perhaps as important, or more important, than financing.

Directors generally stressed the appropriateness of continuing the case-by-case approach of tailoring the mix between adjustment and financing to a country's circumstances and prospects, and they considered that the Fund would continue to have a major role to play in this field. In this regard, debt restructuring and concerted lending, where necessary, would appear to be a pragmatic and appropriate approach to securing additional financing, despite the sometimes admittedly arduous process of assembling financing packages. Developing countries were strongly encouraged actively to promote nondebt-creating capital inflows, particularly direct investment.

While some Directors believed that the problem of external indebtedness required a more integrated approach than the one suggested in the staff papers, I have not discerned today a trend in favor of what some Directors have called generalized debt relief.

Developing countries' external indebtedness to commercial banks

A large number of Directors agreed that enhancing Fund surveillance on a case-by-case basis could make an important contribution to supporting continuing adjustment by countries that were no longer using Fund resources. While noting that the provision of semiannual consultation reports reviewing countries' progress toward a more viable balance of payments position would assist banks in making the transition toward more market-based credit decisions, most Directors stressed that Fund reports should not take a position on the appropriateness of continuing restructuring or additional bank lending. Directors felt strongly that it was up to the banks to utilize the information given to them by the countries concerned; the banks should make their own judgments. Furthermore, Fund reports should be viewed as only one element of the banks' information and monitoring procedures. Directors encouraged the banks to develop their own risk assessment and monitoring capabilities, a process in which the Institute for International Finance might play a useful role. In addition, some Directors said, banks should not take enhancement of Fund surveillance as a signal that they could relax their own monitoring.

Many Directors commented on the need to reinforce the soundness of the international banking system in order to improve the medium-term prospects for lending. They observed that bank supervisors have generally sought improvement in banks' balance sheets in a judicious manner, weighing the need to move rapidly against the risk that an excessively stringent approach could be highly counterproductive. Directors also stressed that more forward-looking risk assessment by banks was an important factor in assisting developing countries to regain more normal market access. These Directors felt that improved risk assessment would be essential to ensure that, over time, the recurrence of cycles of overlending and underlending to individual countries would be avoided, and that financial innovations would be made in a sound manner. Close Fund surveillance of developing and developed countries' economic policies would also support the strengthening of the financial system.

Export credit cover policies

Directors welcomed the opportunity to discuss export credit cover policies in the belief that official export credit agencies would have an important role to play in coming years. The role of official credit insurance agencies was particularly important in helping to maintain vital short-term trade credits, especially in periods in which debtor countries pursued adjustment efforts supported by Fund resources. The recent maintenance of short-term credit insurance by virtually all major agencies--when the appropriate conditions were met--was welcomed by Directors.

As to officially supported commercial credits of longer maturity, Directors believed that the activities of export credit agencies would be crucial in coming years, with the resumption of the growth of capital goods imports in developing countries. The efforts of those countries that make adjustments to restore balance of payments viability over the medium term should be supported by a timely resumption of official export credit and cover. In this way, official export credit agencies could help certain borrowers to gradually regain access to commercial credit. Directors stressed, however, the need to ensure that official export credits were used for productive purposes. In this context, they welcomed the efforts made by official export credit agencies to strengthen their country risk assessment and project appraisal procedures. They noted that lending by those agencies was likely to be most effective and secure when it was part of a well-designed and carefully appraised investment program. In this respect, the role of the World Bank was stressed.

Directors thought that debtors would gain the greatest possible benefit from financial assistance from export credit agencies by being fully aware of the variety of practices and procedures of these institutions. In particular, they should be aware of the linkages between rescheduling and new credit cover.

Developing countries' indebtedness to official creditors

Directors welcomed the efforts by official creditors to respond to the financing needs of countries that were undertaking adjustment programs. They noted in particular the flexibility that had been shown by the Paris Club creditors in reaching agreements that reflected the particular circumstances of individual countries. This case-by-case approach had enabled creditors to deal with each country's immediate financing difficulties while bearing in mind the impact of any rescheduling agreement on a country's access to new export credits and export credit insurance. Given the importance of maintaining or restoring such access, a number of Directors emphasized that rescheduling must continue to be viewed as a response to exceptionally difficult circumstances, and not as an alternative form of balance of payments financing or development assistance.

Some Directors said that, while the Paris Club's activities were welcome, official creditors had responded less flexibly than other creditors. A number of Directors stressed that it would be appropriate for official creditors to take a somewhat longer-term approach to a country's debt servicing difficulties. A number of other Directors, while being receptive in principle to this suggestion, stressed that MYRAs by official creditors should remain the exception, and that MYRAs by banks and by official creditors should not necessarily go hand in hand and need not have identical terms. They also stressed the severe budgetary constraints in a number of creditor countries.

Although Directors differed in their views on when a longer-term approach to a country's debt servicing difficulties would be appropriate, some of them felt that the key question was whether or not multiyear rescheduling by official agencies would facilitate access to new credits and the restoration of normal debtor-creditor relationships. There was agreement that multiyear rescheduling could be a useful response to countries that had made major progress in their domestic and external adjustment efforts but faced a hump in their amortization payments that could not be refinanced through normal market mechanisms. Even in those cases, however, care would have to be taken to ensure that the rescheduling exercise did in fact pave the way for the opening of new export credits and cover. The Fund and the Paris Club will be examining these matters further.

A number of Directors considered that a longer-term approach was also called for in the case of countries--particularly the low-income countries--experiencing prolonged debt servicing difficulties. They believed that the year-by-year approach did not realistically address the situations in these countries, which obviously required very long-term debt restructuring on highly concessional terms. However, other Directors noted the generous terms the Paris Club had been granting such countries and emphasized that these countries' difficulties could only be addressed by strong adjustment efforts supported by appropriate development assistance, which, in their view, should be kept separate from rescheduling policies. Without a firm reorientation of economic and financial policies, even the most generous rescheduling terms were unlikely to generate an increased level of net lending to such countries.

Directors noted the importance attached by all creditor groups to comparability of treatment among creditors and nondiscrimination. For countries experiencing debt servicing difficulties, careful coordination was necessary not only to achieve equitable burden sharing among creditors, but also to ensure an appropriate balance between financing and adjustment.

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/85/45 (3/20/85) and EBM/85/46 (3/20/85).

3. BANGLADESH - TECHNICAL ASSISTANCE

In response to a request from the Bangladesh authorities for technical assistance to improve the fiscal reporting system of the National Board of Revenue, the Executive Board approves the proposal set forth in EBD/85/76 (3/15/85).

Adopted March 20, 1985

APPROVED: January 31, 1986

LEO VAN HOUTVEN
Secretary