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The Chairman's Concluding Remarks on Developing Countries' Indebtedness to Commercial Banks and Official Creditors; and Export Credit Cover Policies
Executive Board Meeting 85/46 - March 20, 1985

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 semi-annual 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.