DOCUMENT OF INTERNATIONAL MONETARY FUND
AND NOT FOR PUBLIC USE

FOR AGENDA

SM/83/45

CONTAINS CONFIDENTIAL
INFORMATION

March 8, 1983

To: Members of the Executive Board

From: The Secretary

Subject: Fund Policies and External Debt Servicing Problems

There is attached for consideration by the Executive Directors a paper on Fund policies and external debt servicing problems, which has been tentatively scheduled for discussion on Wednesday, April 6, 1983.

Att: (1)

Other Distribution:
Department Heads

CONTAINS CONFIDENTIAL INFORMATION

INTERNATIONAL MONETARY FUND

Fund Policies and External Debt Servicing Problems

Prepared by the Exchange and Trade Relations Department

(In consultation with the Area Departments and Other Departments)

Approved by C. David Finch

March 7, 1983

Contents

Contents | Page

I. Introduction

On January 31, 1983, the Executive Board, as part of the World Economic Outlook discussion, considered a staff paper surveying trends and prospects in international capital markets and recent external debt developments. 1/ That paper was mainly of a factual and descriptive nature. The purpose of the present paper is to review, in the light of recent experience, Fund policies and activities in several areas which have a direct bearing on the external debt servicing problems currently faced by many members.

The paper is organized as follows: Section II reviews the dimensions of the current debt servicing problems and discusses the domestic and external factors which contributed to their emergence. Section III summarizes the recent experience with respect to official multilateral debt renegotiations and commercial bank debt renegotiations. Section IV deals with a number of Fund activities related to external debt surveillance, including the provision of technical assistance and improvements in the availability of statistical information, cooperation with the IBRD, the need for a strengthened approach to external debt surveillance in the Article IV consultation process, and cooperation with commercial lenders and supervisory authorities. Section V examines two aspects of external debt problems which arise in the context of use of Fund resources programs: first, issues related to the provision of adequate external financing in support of members' adjustment efforts and, second, issues arising from experience with the 1979 guideline on program performance criteria with respect to foreign borrowing. Finally, Section VI summarizes the main policy issues emerging from the paper on which it would be useful to obtain guidance from Executive Directors during the course of their discussion.

The staff have prepared a number of accompanying papers which deal in more detail with several aspects of external debt servicing difficulties, as follows: (a) "External Debt Servicing Problems--Background Information" (SM/83/46, 3/9/83) which covers these topics: (i) Survey of Official Multilateral Debt Renegotiations, 1975-1982; (ii) External Debt Management of Selected Member Countries; and (iii) Experience with External Debt Limitations in Fund-Supported Programs, 1979-82; (b) "Payments Difficulties Involving Debt to Commercial Banks" (SM/83/47, 3/9/83); (c) "Data on International Banking and External Debt" (SM/83/48, 3/8/83) prepared by the Bureau of Statistics; and (d) "External Debt and Debt Service of Developing Countries" (SM/83/49, 3/8/83).

1/ "World Economic Outlook--Trends and Prospects in International Capital Markets and Survey of External Debt Situation," (ID/83/2, 1/19/83).

II. Background

1. Dimensions of external indebtedness and debt servicing problems

The external debt situation of the non-oil developing world has come under increasing pressure in the last two years. 1/ Although there has been a sharp slowdown in the growth of outstanding debt, owing to the accumulated weight of past borrowings, the debt servicing burden has intensified markedly. It was further aggravated in 1982 by the world recession, the continuation of an historically high level of interest rates during 1982 (despite a marked fall over the course of the year) and the broad declines in export earnings for many countries.

For an unprecedented number of countries, the debt servicing burden has reached critical proportions, as reflected in the record number of debt reschedulings and a sharp rise in external payments arrears. Twenty countries undertook multilateral debt renegotiations in 1982, compared with 13 in 1981 and 7 in 1980; the number of debt renegotiations in the second half of the 1970s only averaged 4 countries per year. More significantly, until recently, most renegotiations were for relatively small debtors (e.g., low-income countries) or for larger debtors in a country-specific context (e.g., Turkey). In contrast, the situation in 1982 has been characterized by many as a generalized debt problem, as for the first time, 7 of the countries that have needed to undertake a debt rescheduling were among the largest debtors, including a number of net oil exporters. The scale and the apparently abrupt emergence of these recent debt servicing difficulties have heightened concern about the capacity of the developing countries to service their debt and the potential disruptive impact on the international banking system.

A major aspect of the current external debt problems faced by the developing countries involves debt owed to commercial banks. During the four-year period ending 1981, net banking flows to the non-oil developing countries averaged approximately 60 per cent of their combined current account deficit, while in recent years bank debt restructuring exercises have exclusively involved countries in this group. At the same time, a relatively small number of countries account for the bulk of commercial bank exposure to the group of non-oil developing countries. Indeed, in June 1982, 47 per cent of the net external claims of banks in the BIS reporting area on non-oil developing countries were on the three largest debtor countries currently experiencing difficulties (i.e., Argentina, Brazil, Mexico), while 62 per cent of total claims were on the 10 largest non-oil developing country borrowers which are facing difficulties. Thus, partly due to the regional aspects of the present problem (in particular the relative

1/ For a more detailed account of the recent external debt situation, see ID/83/2.

concentration vis-a-vis Latin American countries), there is a considerable concentration in the portfolio of banks on countries which have sought, or are currently seeking, some form of restructuring of their debt. Moreover, the banks' exposure to these countries is perceived to be large in relation to their capital. The exposure of some major international banks to borrowers in individual countries in that group exceeds 50 per cent of their capital, and, in a number of cases, the combined exposure to the three largest borrowers experiencing difficulties exceeds their capital. Bank supervisory authorities and legislators in a number of creditor countries have expressed their concern over the concentration of sovereign risk as well as the adequacy of bank capital, and there is some evidence to suggest that developments in the interbank market and movements in bank equity prices have reflected these concerns. These factors may have reinforced the banks' own evolving perception of risk and contributed to the marked slowdown in international bank lending in the second half of 1982, particularly in lending to non-oil developing countries which appears to have taken place.

2. Sources of debt servicing difficulties

The underlying causes of the recent and widespread debt difficulties can be traced in part to a series of adverse external developments since the late 1970s, namely, the sharp rise in oil prices in 1979-80, large increases in international interest rates, and the global recession that began in 1980. The oil price increase, followed by the recession-induced slump in other commodity prices, has given rise to a considerable deterioration in the terms of trade and the external account position of most non-oil developing countries. 1/ Thus, to offset the loss in import purchasing power, many countries engaged in external borrowing on a larger scale. Moreover, there has been a fundamental change in the world economic environment from inflation to disinflation. In the second half of the last decade, frequently negative real rates of interest encouraged the contracting of external debt, and the easy availability of external finance masked potential underlying problems of debt servicing capacity of many borrowing countries. By contrast, the disinflationary policies adopted subsequently in major industrial countries have entailed historically high nominal and real international interest rates and a consequent rise in borrowing costs. 2/

While widespread debt servicing difficulties have been triggered to a considerable extent by unfavorable external circumstances, they also reflect inadequate domestic economic management in many of the countries concerned. During the last few years, countries attempted to

---

1/ During the five years between 1978 and 1982, these countries on average suffered a cumulative loss of 20 per cent in the terms of trade.

2/ The average interest cost of borrowing by non-oil developing countries on credits obtained from all sources jumped from 6 per cent in 1974-78 to 11 per cent in 1981; despite a subsequent drop due to global disinflation, the prevailing level (at about 8 per cent in early 1983) is still high by previous standards (see also ID/83/2, Table 19, p. 44).

adjust to the worsening environment in varying degrees and, for many, adjustment was insufficient or unduly postponed. Excess demand and balance of payments pressures often originated in the sphere of public finances, and were reflected in mounting fiscal imbalances and low domestic savings. Frequently, financing of these imbalances took place through domestic credit expansion, in addition to sharp increases in external borrowing. Domestic cost-price distortions tended to become more prevalent, output growth generally suffered, and the external accounts weakened further, prompting even larger external borrowings on relatively harder terms. In the process, the exchange rate often became unrealistic and the consequent loss in competitiveness increased the pressures on the current account, while also encouraging speculative capital outflows. In many cases, high domestic inflation rates and interest rates caused financial imbalances to emerge within the private sector, which in turn were financed by increased external borrowings.

The demand for foreign financing in amounts and on terms that were sometimes out of line with the economy's debt servicing capacity was accommodated by the concomitant and exceptional increases in the availability of external finance from private sources, especially in the late 1970s. 1/ Such a heavy reliance on commercial borrowing also weakened the maturity structure of debt and, by now, this buildup in debt is already being reflected in a bunching of repayments. Moreover, even when foreign borrowing has been for productive investment, the shift in the maturity profile has also increased countries' vulnerability to the emergence of possibly temporary, but nevertheless serious, debt servicing problems.

For countries most affected by debt servicing difficulties, it has usually been a reduction in the supply of funds that triggered the debt crisis and led to the need for restructuring. In this final phase of the debt problem, the typical debtor country has already exhausted most ad-hoc adjustment measures and external reserves are often at minimum working levels. At this point, a similar and quite well-defined sequence can be observed for many countries, although the general process described below may differ somewhat in specific country cases. Initially, as the debtor country's creditworthiness is eroded, it experiences a slowdown in the rate of capital inflows, as well as a hardening of borrowing terms. Its traditional long-standing creditors may attempt to curtail their exposure, and the debtor is compelled to diversify its sources of credits. Next, as the perception of a reduction in creditworthiness spreads, the debtor is faced with severe restrictions on the type of credits available. The creditors' increased reluctance to lend at this stage is often reflected in their preference for short-term rather than medium-term commitments which creditors

---

1/ Thus, the estimated growth in bank debt, according to BIS data, accelerated to 30 per cent per year during 1978-80, from about 20 per cent per year in 1974-77. (See also ID/83/1, "World Economic Outlook--General Survey," p. 29.)

individually perceive as a reduction in their risk exposure; in aggregate, however, the shift to short-term finance increases the risks for both debtor and creditors alike. The final crisis stage, which can be triggered by events external to the particular debtor concerned, is characterized by a disruption in normal trade-related short-term debt, and by the debtor's frequent inability to obtain a rollover of other types of financial short-term debt. Moreover, once this process begins, the desire of individual creditors to reduce their exposure may lead to a downward spiral in the availability of any form of external finance. Unless the debtor initiates discussions with creditors promptly and in advance of payments delays, arrears inevitably emerge which further compound the problem, and the debtor is finally forced to approach creditors to arrange some form of refinancing or restructuring arrangements.

The overall prospects for an alleviation of debt servicing difficulties in 1983 depend on several factors. A major element concerns the need for creditors to perceive that debtors have already in place realistic domestic policies designed to ensure the effective utilization of available foreign savings. Thus, the implementation of sound adjustment efforts on the part of the countries concerned can serve to significantly lessen the present "crisis of confidence" and help avert the emergence of cumulating short-term liquidity problems. At the same time, however, it should be recognized that the restoration of confidence may take some considerable time and will not be easy to achieve. A second crucial factor relates to the prospects for an improvement in the international economic environment. For a number of countries, the debt servicing problems they face are of such a magnitude that efforts to reduce sufficiently their external current account imbalances by domestic adjustment measures alone may prove to be extremely difficult. Thus, for these countries, even with effective adjustment policies, the extent to which their present debt servicing difficulties can be resolved in the period ahead will depend on the degree of economic recovery in the industrial world, the maintenance of an open trading system, the growth of world trade, and the extent of further progress in reducing interest rates and in sustaining a lower rate of world inflation. In addition, and aside from the granting of debt relief which has become necessary in many instances, the availability of balance of payments assistance from official sources and multilateral institutions will play a crucial role.

III. Experience with Debt Rescheduling

As indicated above, the present debt servicing difficulties have led a record number of countries to seek a rescheduling of their external debt obligations. This section reviews, in turn, recent experience with official multilateral debt renegotiations and commercial bank debt renegotiations.

1. Official multilateral debt renegotiations 1/

a. Summary of experience

Official multilateral debt renegotiations are normally undertaken under the aegis of the Paris Club, which deals with debt owed to or guaranteed by the governments and the official agencies of the participating countries. Normally, both principal and interest payments on medium- and long-term loans, as well as related arrears, are rescheduled. As a general rule, the Paris Club does not reschedule payments related to short-term debt or those which have already been rescheduled. Although there have been some exceptions with regard to short-term debt, the exclusion of previously rescheduled debt has been virtually complete. While there have been two instances during 1975-1982 where rescheduled debt was consolidated, only one of them--undertaken outside of the Paris Club--involved a substantial amount and a long repayment period. In February 1983, another highly unusual exception was made for the rescheduling for Sudan, where 100 per cent of arrears on principal and interest payments resulting from the previous consolidations, as well as 100 per cent of payments due in 1983 on short-, medium-, and long-term debt, were rescheduled with a long repayment period. Another feature of the Sudan rescheduling is that one half of the interest due in 1983 on the amount rescheduled was capitalized and consolidated together with the other payments. The creditors have made it clear that they regard the circumstances of the rescheduling for Sudan as unique.

The consolidation period is normally 12 to 18 months. However, a majority of countries obtained debt relief more than once and, thus, in these instances, the consolidation became de facto medium-term. For cases of acute difficulties, the consolidation period resulting from several reschedulings often exceeded 18 months. Interest rates on the rescheduled debt are determined bilaterally between the debtor and each creditor country, and, while market-related, are often somewhat below current commercial market interest rates.

The agreements specified the repayment schedule for payments which were rescheduled and, also, for those which were not. The schedule for the latter normally involved a postponement from the original due date. Thus, in most cases, although 80-90 per cent of eligible payments were formally consolidated, effective rescheduling was somewhat larger. Generally, repayments were made, first, in a relatively small amount for 3-4 years and, subsequently, in a larger amount for 4-5 years. Recently, the length of the first period became longer and annual average payments became smaller. The 1983 Sudan rescheduling went well beyond the established norms by providing for no repayments, except interest, for 5 1/2 years following the consolidation period, and a repayment period of 9 1/2 years thereafter.

1/ A detailed survey of the experience during 1975-1982 is contained in Part I of the "Background Information" paper (SM/83/46, 3/9/83).

The agreements stipulated, in all cases except those for India which were undertaken under aid consortia, that the debtor country would seek renegotiation of private debt and would not agree to a rescheduling that would result in a more favorable treatment being given to any other creditor than to the participating creditors. There was a parallel commercial bank debt rescheduling in most recent Paris Club cases.

The creditors have held the view that, in receiving debt relief, the debtor country must take measures to restore its financial viability. For this purpose, a Fund member debtor country was required, as a precondition to convening the meeting to discuss the rescheduling, to conclude a financial arrangement with the Fund subject to upper credit conditionality; 1/ also, when further possible rescheduling of payments falling due in the near future was envisaged, such rescheduling was subject to the condition that the country continued to have a Fund-supported program or remained eligible to draw under the existing program. When creditors agreed to consider further debt relief in the period after the consolidation period, the country was asked to have a Fund-supported program in place at the time the discussion of such debt relief took place. Recently, in several cases where the creditors thought that the debtor country's balance of payments problem was particularly serious, the agreed consolidation was made conditional upon the observance of performance criteria during the period of the financial arrangement with the Fund.

In a large number of cases, official debt relief contributed substantially to financing the balance of payments deficits of the debtor countries. In about one half of all cases, the amount of debt relief was equivalent to more than 50 per cent of the current account deficit, while in about one third, it represented more than 30 per cent of annual export earnings. The amount was, however, rather small relative to the debt outstanding in about two thirds of the reschedulings. Also, the quantitative significance of debt relief declined markedly in 1982, largely because most of the reschedulings in that year involved debtor countries which had arranged a rescheduling previously, and the previously rescheduled payments were not accepted for consolidation.

b. Current policy issues

The conventional Paris Club rescheduling terms are designed to help the debtor countries bridge temporary liquidity shortages. Recognizing that the difficulties are no longer of a temporary nature for several countries, the Paris Club creditors are currently in the process of reviewing their policies with regard to rescheduling for countries with structural debt problems. Official creditors are firmly

---

1/ If the debtor country is not a Fund member, the creditors asked the debtor to submit a memorandum describing the adjustment measures adopted and formed a task force to review the progress achieved.

of the view that debt relief granted by them should not be a vehicle for concessional development finance. They also hold the view that the debt relief agreement should always require a minimum current payment of debt service, and normally should not involve the rescheduling of short-term debt or a repayment period on the rescheduled amount in excess of ten years. However, for Sudan which faced uniquely severe debt problems, the creditors have granted debt relief on terms and under procedures which, while safeguarding the principles of the Paris Club, involve repayment periods in excess of ten years and a consolidation of previously rescheduled debt. It is also recognized that in the case of many low-income countries, even with satisfactory adjustment policies, the success of debt rescheduling is likely to be strongly influenced by the availability of sufficient concessional aid assistance.

Official creditors consider that effective debt relief operations would now require closer cooperation with the Fund and the IBRD and with commercial banks. In addition, besides the debt owed to official creditors and commercial banks, countries usually have a large amount of liabilities to private suppliers which are not guaranteed by official agencies. The negotiation to consolidate these credits is usually particularly difficult because of the involvement of a large number of creditors with relatively small claims, and there have been few successful multilateral reschedulings of nonguaranteed suppliers' credits. The issue of ensuring equitable burden sharing in practice with private suppliers has not yet been adequately resolved.

2. Commercial bank debt restructuring

a. Summary of experience

With the sharp increase in the number of countries approaching banks to seek debt renegotiations, restructurings are rapidly losing their exceptional character and the process appears to have become more efficient and perhaps more standardized over time. This trend is clearly reflected in recent cases by the more rapid initiation of discussions at the very onset of difficulties, and by the shortening of the time required to conclude the negotiations. During the five years prior to 1982, only three of the seven countries negotiating their first bank debt restructuring concluded the agreement in under one year, while of the seven agreements concluded subsequently, five were completed in less than one year. Of the nine countries currently engaged in negotiations, in only three cases have the discussions been under way for over 4 months. Where countries have had successive reschedulings, negotiations often have been expedited by the statistical work already completed, the precedents set previously, and the existence of bank steering groups. Thus, four of the five countries which have concluded more than one restructuring arrangement since 1978 completed negotiations after 8 months or less; in the four negotiations of this type currently in progress, in only one case have significant delays occurred.

Generally speaking, agreements in recent bank debt restructuring have applied to future maturities falling due within approximately 12 months from the onset of negotiations, although there were consolidation periods of up to 2 and 3 years in exceptional cases. In a number of instances, arrears on principal payments were also rescheduled, but this has been less of an issue in some of the more recent large scale restructurings to the extent that debtors had approached banks on a timely basis. Interest payments in arrears were rescheduled only in exceptional cases, and none of the concluded agreements included future interest payments. Table 1 summarizes the key elements of the agreements which are reviewed in detail in the companion paper "Payments Difficulties Involving Debt to Commercial Banks" (SM/83/47, 3/9/83). 1/

As in the case of restructurings of official debt, private bank creditors generally have urged countries experiencing payments difficulties to negotiate upper credit tranche programs with the Fund; in almost all cases this was done. Rescheduling agreements generally contain provisions outlining the conditions under which creditors have the right to declare rescheduled loans due and repayable on demand. These provisions, which cover a wide variety of circumstances, often include nonfulfillment of "equal treatment" clauses with respect to other creditors. Recent agreements have also provided for the possibility of accelerated repayment in the event that the debtor becomes ineligible to draw under an arrangement with the Fund.

In all of the completed agreements examined, at least 80 per cent of the maturities falling due were restructured, and in about half of the cases the total amount was rescheduled. In those exceptional instances where arrears were rescheduled, the terms were similar to those applied to rescheduled future short-term debt. The restructuring of future maturities typically carried 7-8 years maturity and 2-3 years grace, but there were a number of exceptions and, in some cases, maturities have ranged to over 10 years. On occasion, the maturity of the rescheduling of short-term debt was shorter than that applicable to medium-term debt. In general, the average maturities on rescheduled debt were comparable to those on new medium-term bank commitments. Regarding interest charges, in the majority of restructuring agreements concluded during 1978 through January 1983, the spread over LIBOR or the U.S. prime rate ranged typically between 1 3/4 and 2 per cent.

1/ The country cases reviewed in that study include only those involving formal multilateral restructuring arrangements, and instances of bilateral resolutions of debt difficulties are excluded. In addition, the multilateral restructuring negotiations currently in progress regarding debt to commercial banks of the Dominican Republic, Honduras, and Venezuela have not been included because sufficient information was not yet available when the country studies were prepared. Developments in these and other cases under negotiation will be summarized in the next paper reviewing developments and prospects in international capital markets.

Table 1. Chronology of Bank Debt Restructuring Arrangements

Country and Date of Signature	Amounts Consolidated: Total	Amounts Consolidated: Of which in arrears	Terms of Arrangements: Proportion of rescheduled amounts: Future maturities	Proportion of rescheduled amounts: Arrears	New maturities: Future maturities	New maturities: Arrears	Grace period: Future maturities	Grace period: Arrears	Interest rate spread over: LIBOR	Interest rate spread over: U.S. prime
	(In millions of U.S. dollars)		(In per cent)		(In years)				(Percentage points)	
Completed 1/										
Peru (June 1978)	186	(--)	100.0	--	0.75	--	--	--	...	...
Jamaica (Sept. 1978)	63	(--)	87.5	--	5.00	--	2.00	--	2.000	--
Peru (December 1978)	200	(--)	90.0	--	5.00	--	2.00	--	1.875	--
Jamaica (April 1979)	149	(--)	87.5	--	5.00	--	2.00	--	2.000	--
Turkey (June 1979)	560	(--) 2/	100.0	--	3.00 to 7.00	--	0.00 to 3.00	--	1.500 to 1.750	--
Turkey (August 1979)	2,200	(--) 2/	100.0	--	7.00	--	3.00	--	1.750	--
Peru (January 1980)	340	(--)	90.0	--	5.00	--	2.00	--	1.250	--
Togo (March 1980)	69	(25) 2/	100.0	100.0	3.50	1.50	1.00	0.50	1.500	...
Zaire (April 1980)	402	(287) 2/	100.0	76.0	10.00	10.00	5.00	5.00	1.850 to 2.000	--
Bolivia (August 1980)	156	(...)	100.0	--	0.75	0.75	--	--	1.375	...
Nicaragua (Dec. 1980)	562	(322)	100.0	75.0 to 100.0	12.00	5.00 to 11.00	5.00	0.00 to 5.00	0.750	1.250
Jamaica (July 1981)	89	(--)	100.0	--	5.00	--	2.00	--	2.000	--
Bolivia (April 1981)	416	(172)	90.0	80.0	5.00 to 6.00	3.50 to 7.00	2.00	2.00 to 3.00	2.250	--
Nicaragua (Sept. 1981)	180	(...)	100.0	90.0	10.00	10.00	5.00	1.00	0.750	1.250
Sudan (December 1981)	568	(568)	--	82.0 to 100.0	--	3.00 to 7.00 3/	--	0.00 to 3.00	1.750	--
Turkey (March 1982) 4/	2,900	(--)	100.0	--	3.00 4/	--	2.00 4/	--	1.750	--
Nicaragua (March 1982)	55	(...)	100.0	90.0	10.00	10.00	5.00	--	0.750	1.250
Poland (April 1982)	2,300	(--) 2/	95.0	--	7.00	--	4.00	--	1.750	--
Senegal (June 1982)	77	(...) 2/	90.0	90.0	6.50 to 7.50	6.50 to 7.50	3.00 to 4.00	3.00 to 4.00	2.000	--
Guyana (June 1982)	14	(--) 2/	100.0	--	6.00	--	0.50	--	2.500	--
Liberia (July 1982)	13	(--) 2/	95.0	--	6.00	--	3.00	--	1.750	--
Poland (November 1982)	2,300	(300) 2/	95.0	95.0	7.50	7.50	4.00	4.00	1.750	1.500
Malawi (November 1982)	42	(--)	100.0	--	6.50	--	3.00	--	1.875	--
Romania (December 1982)	1,900	(...) 2/	80.0	80.0	6.50	6.50	3.00	3.00	1.750	--
Ecuador (January 1983) 5/	970	(--)	90.0	--	6.00	--	1.00	--	2.250	2.125
Under negotiation										
Argentina	8,000 to 10,000	(...)	100.0	100.0	7.00	7.00	3.00	3.00	2.125	2.000
Brazil	4,700	(--)	100.0	--	8.50	--	2.50	--	2.250 to 2.500	1.875 to 2.250
Chile	2,600	(--)	100.0	--	8.00	--	5.00	--	...	...
Costa Rica 6/	228 7/	(112) 7/	...	...	...	...	...	...	...	...
Cuba	1,000	(--)	100.0	--	10.00	--	3.00	--	...	...
Madagascar	195	(70) 2/	...	...	...	...	...	...	...	...
Mexico	14,900	100.0	100.0	--	8.00	--	4.00	--	1.875	1.750
Poland	...	...	...	...	...	...	...	...	...	...
Romania	515 8/	-- 2/	60.0 8/	--	6.00	--	4.00	--	1.750	--
Togo	...	...	...	...	...	...	...	...	...	...
Yugoslavia	1,400	--	100.0	--	3.00 to 5.00	--	--	--	...	...

Sources: Restructuring agreements; and Fund staff estimates.

1/ Formal agreements reached in principle or signed as of January 31, 1983.

2/ Interest in arrears had (or have) to be cleared before actual signing of the agreement.

3/ With respect to principal in arrears; the grace period was 0 and the new maturity 3 years with respect to interest in arrears.

4/ Final maturity was extended from 7 years to 10 years and the grace period from 3 years to 5 years.

5/ The amount consolidated and the related terms refer to the maturities deferred in 1983, which will be rescheduled on December 31, 1983.

6/ Agreement (in principle) reached in December 1982 on interest which provides for a revolving short-term trade facility equivalent to 50 per cent of the combined amount of interest in arrears as of December 31, 1982, current interest due in 1983, imputed interest on interest in arrears and interest for bonds. This agreement is conditional upon a concomitant agreement on principal, which has not yet been reached.

7/ Interest only.

8/ In addition, 10 per cent of the downpayment due in 1983 is deferred to 1984.

For those arrangements currently under negotiation, proposed spreads in general are higher than in earlier agreements. To the extent that restructuring agreements have incorporated new lending commitments, these often involved spreads, grace periods, and final maturities quite similar to the rescheduling agreements per se. There is very little published information available regarding the fees and charges involved in the restructurings, but these are believed to have been substantial in some instances.

b. Issues in commercial bank debt restructuring

Since in quantitative terms, many of the important initiatives in the area of commercial bank restructuring have come within the past few months, it would be premature to enter into generalizations at this juncture, as many important issues in specific country cases are still evolving. Nevertheless, an examination of the principal issues which have arisen will aid in understanding some of the difficulties which emerge in countries' attempts to find a resolution of their external debt problems and their implications for the countries' adjustment efforts.

One of the important issues which has emerged has been that of the timing of a country's approach to commercial banks. In general, it cannot be in the best interest of any of the parties involved to enter lightly into a restructuring of commercial bank debt or otherwise seek relief from contractual obligations. However, in instances where such an approach had become inevitable, but was not initiated and concluded on a timely basis, experience has shown that the delay frequently exacerbated the emerging debt servicing difficulties. The persistence of unresolved debt servicing problems results in a decline in creditor confidence. In such cases, commercial banks, individually and as a group (as well as other lenders), have typically slowed new lending and have withdrawn short-term credits, interbank deposits, and trade credits. This aggravated the balance of payments position of the country, jeopardized the assets of lenders who did not or could not reduce their exposure, and made the formulation of a viable balance of payments program more difficult. In light of these considerations, it is not surprising that recent experience indicates that, in general, the more dependent a country was on market borrowing for external finance, the more rapidly it initiated negotiations in the face of a perceived or actual change in market sentiment.

Without a timely and coherent resolution of an emerging debt problem, there exists the possibility that banks' attempts to reduce their exposure would give rise to problems of intercreditor equity involving difficult questions about the distribution of the restructuring "burden." On occasions, the need to resolve these issues has led to significant delays in reaching agreement. In cases where bank debt involved a large number of institutions, banks in general placed great emphasis on maintaining "market discipline," i.e., preventing an uneven reduction in exposure by different lenders during the period when

restructuring arrangements were being negotiated. In recognition of these kinds of problems, commercial banks in several very recent instances were willing to accept a "standstill"--in some cases unilaterally imposed by the country--on the repayment of principal on medium-term debt and on short-term debt. The effect is to maintain the total exposure of all institutions and to permit the restructuring process to proceed without aggravating balance of payments pressures.

In many problem cases, the reduction of bank exposure has resulted in a rapid loss of the debtors' foreign exchange reserves and the accumulation of payments arrears. These developments compounded the confidence problem and even jeopardized the normal flow of trade finance. Moreover, in most of the instances where arrears had accumulated, particularly on interest payments, bank debt restructuring agreements have been considerably more difficult to complete. With few exceptions, the banks have resisted the rescheduling of interest in arrears. This attitude reflects constraints imposed by bank supervisory authorities on the classification of assets, as well as by questions of future profits, and the banks' own funding activities. Because of these considerations, banks have generally insisted on an elimination of such arrears as a precondition to a debt restructuring. In certain cases, significant problems have arisen for the design of a viable adjustment program, due to the initial drain on the debtor's external resources associated with the clearing up of arrears when the agreement was signed. In some instances, the banks agreed to help overcome this problem by committing new funds as part of the restructuring agreement. In other cases, banks have been willing to reschedule short-term debt in arrears.

Several questions relating to the issue of intercreditor equity have arisen in the context of determining the coverage of restructuring agreements. Of particular importance has been the treatment of short-term debt and interbank deposits, as well as the treatment of bank credits relative to nonbank commercial debt, floating rate notes, officially guaranteed debt, and nonguaranteed export credits. The search for a resolution of these matters has become an important and complex part of the debt restructuring process. In some pending cases, the proposed agreements include undertakings not to reduce short-term credits and interbank deposits.

Increasing bank exposure in conjunction with a bank debt restructuring through the commitment of new funds has become of paramount importance in some recent major instances. In theory, any required net inflow of funds could be achieved by a lesser amount of new lending accompanied by rescheduling on very generous terms with long grace periods and maturities and perhaps less-than-market-related interest rates. However, banks are extremely reluctant, lest the earning capacity of their assets be eroded, to reschedule on less than "market" terms if they are to continue to maintain a net financing presence in the country. Thus, it appears to be widely perceived that it would be counterproductive for a country to seek "nonmarket" terms if it is

intended that the country's access to normal credit facilities should resume (even with some time lag) after the rescheduling process is completed.

Associated with the initiatives of Fund management as described in more detail in Section V.1.a, below, large new ex ante lending commitments have formed an integral part of the restructuring process for Argentina, Brazil, and Mexico, and in some other cases (e.g., Yugoslavia) an attempt has been made to avoid a formal rescheduling by negotiating an increase in the banks' exposure through significant new lending commitments. Although there undoubtedly is a trade-off between receiving debt relief and receiving additional loans which would permit the maintenance of regularly scheduled debt service, the weight of scheduled interest payments in some recent cases has proven to be so burdensome that any rescheduling of principal payments on "commercial" terms has required a commitment of new funds if interest is to be paid as scheduled.

The restructuring terms applied to official and bank debt undoubtedly have become increasingly harmonized in recent years, even though official creditors in general have not had to draw a sharp distinction between rescheduling arrears on payments of principal and on interest. In some instances, where the debt to official institutions was relatively large, the debtor country made simultaneous approaches to official and commercial lenders. However, in some recent important cases, the bank rescheduling was not linked in any way to a multilateral rescheduling of official debt.

IV. Fund Activities Related to External Debt Surveillance

This section reviews Fund activities in the external debt field apart from those aspects relating to the use of Fund resources which are dealt with in Section V. Subsection 1 provides a brief review of the Fund's role in providing technical assistance to members in the external debt field and in improving the availability of debt statistics. This is followed by a review of the cooperation between the Fund and the IBRD in the area of external debt. Subsection 3 discusses external debt surveillance issues in the context of the Article IV consultation process. Finally, some issues related to cooperation with commercial lenders and supervisory authorities are reviewed.

1. The provision of technical assistance and improvements in debt statistics

A recent staff survey of external debt management policies in selected member countries [see Part II of the "Background Information" paper (SM/83/46, 3/9/83)] indicates that, for most of the largest borrowing countries, the coverage and timeliness of debt statistics as well as the mechanisms for controlling foreign borrowing by the public sector are at present reasonably adequate to permit the formulation and

effective implementation of debt management policies. In several instances, countries strengthened their debt management procedures after having encountered debt servicing difficulties. However, for some of the large borrowers and for many other countries, there is room for much improvement in the mechanisms for monitoring external debt, an area which can be an important contributing factor to the emergence of debt servicing difficulties. As a response to this problem, the Fund has recently expanded the role of the Central Banking Department in order to provide technical assistance to selected member countries in the external debt field. 1/ The expanded program will focus on the setting up of machinery to monitor and control external borrowing operations, and the collection of detailed loan-by-loan statistics. This initiative, the staff believe, should, over time, make a substantial contribution to lessening those technical obstacles which, for some members, are a significant hindrance to the implementation of a sound debt management policy.

So far as the greater availability of information is concerned, the accompanying paper prepared by the Bureau of Statistics, "Data on International Banking and External Debt" (SM/83/48, 3/8/83) describes in more detail the steps that have been taken to expand the Fund's work on the measurement of debt, including a more systematic accounting of statistics on international banking flows. There is scope for substantial improvement in this area as regards better reporting methods and ensuring consistency between data obtained from various sources, as well as, in particular, covering short-term debt more adequately. Also, in the staff's view, consideration should be given to the feasibility of the Fund publishing certain available external debt statistics on a continuous basis, for example, in International Financial Statistics. Efforts such as these would serve to provide a more comprehensive, accurate, and readily available picture of external debt developments, and thus improve the basis for decision-making by both official and private creditors.

2. Cooperation with the IBRD

The Fund staff have cooperated closely with the staff of the IBRD in efforts to improve the informational and institutional aspects of external debt management in member countries. At the working level, there is a continuous exchange of statistical information relating to recent external debt developments of individual members. In particular, the Fund staff have relied heavily on the Debtor Reporting System (DRS) which is maintained by the External Debt Division of the Bank and which the Bank is currently expanding and improving. The DRS data, apart from being extremely useful for analyzing each country's medium- and long-term debt developments in detail, have also been an important source of information for the regional and aggregative debt analysis undertaken as part of the Fund's World Economic Outlook. It is also intended that

1/ See "Expansion of Central Banking Department Technical Assistance Activities in the External Debt Area," (EBD/82/316, 12/22/82).

the Fund's expanded program to provide technical assistance in the area of debt management procedures (referred to earlier) will be implemented in close collaboration with the Bank staff concerned.

As regards the assessment of countries' debt management policies, the Fund staff have sought the views of Bank staff on a case-by-case basis in line with the general understandings regarding Fund-Bank collaboration. In addition, a statement issued by the Bank management and distributed to the Fund Executive Board in 1972 outlined the informal arrangements between the Bank and the Fund for cooperating in the specific field of debt management. 1/ These guidelines noted the continuous exchange of views between the staffs of the two institutions regarding the debt prospects of individual countries and the policy steps that may be necessary to manage their external debt effectively. In the context of use of Fund resources programs, it was noted that the reaching of understandings concerning members' external borrowing limitations would normally be made after consultation between the Bank and the Fund staff. Experience indicates that the Fund staff have found it especially useful to discuss with their Bank colleagues the medium-term outlook of the economy and the desirability of promoting external debt management policies which maximize the efficient use of available foreign savings.

The above statement also referred to the cooperation between the Fund and Bank staff in debt renegotiation meetings. It noted that in some instances, the two organizations have worked jointly in providing background information for the participants in the negotiations. This aspect of cooperation has continued in recent years and, in several instances, has proven especially important as regards efforts to establish as consistent a statistical data base as possible.

3. Debt surveillance in Article IV consultations

While all efforts should be made to improve the technical and informational aspects of debt management policy, it should be emphasized that the majority of debt servicing problems arise not so much from a lack of data or of institutional procedures, but from failure to define a debt policy and from the adoption of underlying domestic policies which lead to an outcome inconsistent with the debt servicing capacity of the economy. As the discussion in Section II indicated (and this is confirmed by the individual surveys of debt management policies referred to earlier), an insufficient degree of domestic economic adjustment to changed external circumstances often leads to amounts and types of external borrowing which are unsustainable.

External debt policies of members have always been an important concern of the Fund. The Executive Board decision setting forth the

---

1/ "Bank and Fund Cooperation in Assisting Debt Management," IBRD (Sec M 72-78), February 8, 1972.

"Principles of Fund Surveillance over Exchange Rate Policies" states, inter alia:

> The Fund's appraisal of a member's exchange rate policies shall be based on an evaluation of the developments in the member's balance of payments against the background of its reserve position and its external indebtedness. 1/

The increased debt servicing problems faced by many member countries at present underscore the importance of including as comprehensive an assessment as possible of external debt policies in order to facilitate the Board's being informed at an early stage of potential payments difficulties. In the past, staff consultation reports dealing with Article IV consultation discussions have made reference to the external debt position of members, and the staff appraisal has, in several instances, discussed the policy intentions of the authorities in the area of external debt management. However, in the staff's view, there is need for significant improvement in the area of external debt surveillance within the Article IV consultation process. Consistent with suggestions voiced by several Executive Directors recently, it is proposed that for members engaged in significant external borrowing operations, the coverage of external debt matters in Article IV reports be strengthened by including a forward-looking external debt analysis which would form the background against which the staff would report upon and assess the member's intended external debt policies.

At the same time, efforts will continue to present, especially in Recent Economic Developments reports, as comprehensive a coverage as possible of recent external debt developments. The staff will pay particular attention to statistics concerning short-term debt and to the external debt monitoring and decision-making procedures of members. RED reports at present include only projected debt service payments relating to existing debt. Since the forward-looking debt analysis suggested below requires the presentation of additional statistical material, Executive Directors may wish to consider whether such material could be included in RED reports in the future, or whether it should appear, possibly as an annex, only in the staff report (Part I) of the Article IV consultation.

Experience has shown that the adequacy of international reserves in relation to unexpected movements in short-term liabilities is an essential element to reduce members' vulnerability to random events. The Article IV reports will therefore pay additional attention to the relation between short-term external assets, short-term liabilities, and unused lines of credit as a part of the overall description of recent debt developments.

1/ Decision No. 5392-(77/63), April 29, 1977.

A forward-looking analysis of the external debt situation

In the staff's view, a meaningful assessment of the sustainability of the present and possible future external debt situation requires an analysis of the debt servicing capacity of the economy in the medium term. Forward-looking analysis of this kind has proved to be extremely useful when analyzing the medium-term viability of the external sector of members in programs supported by use of Fund resources (see Section V.2, below). The purpose of the approach is to assess the adequacy of external debt policy in terms of whether the present and prospective levels of external borrowing are sustainable. Conceptually, it can be viewed as consisting of two steps: first, a technical analysis of the implications for the future evolution of the debt service burden in the medium term (for example, during the next five years) of alternative paths for the external current account; and, second, a review of the policies which may be needed in order to ensure achievement of current account targets which are consistent with the maintenance of debt service payments within appropriate bounds.

(i) A medium-term debt scenario

The objective of the exercise is to analyze the possible debt service burden associated with alternative paths for the external current account in the period ahead. Apart from debt servicing relating to existing debt, the approach incorporates future debt servicing associated with gross new borrowings required to finance prospective deficits as well as amortization payments which fall due in the period ahead; the prospective borrowing levels envisaged would also allow for the maintenance of an adequate level of external reserves. Depending on the composition and terms assumed for gross new borrowings (for which various possibilities might be examined), the exercise provides illustrative paths for debt service payments associated with a range of alternative future outcomes for the external current account. Moreover, for any hypothetical current account target and an associated path for debt interest payments, a prospective growth in export earnings would imply a corresponding time path for the level of imports of goods and services.

The above technical analysis should not be viewed in any sense as a predictive exercise, but rather as an analytical tool for strengthening the basis of the judgmental elements involved. The analysis normally would be prepared by the staff in close cooperation with the authorities of the member country, and thus would incorporate fully the specific features of each economy. However, in order to preserve consistency of treatment and to facilitate intercountry comparative assessments, there is considerable merit in maintaining a reasonable degree of uniformity so far as presentational and methodological aspects are concerned. For example, it is envisaged that the format of the "medium-term outlook analysis" would follow closely that outlined above (see Annex B illustrating the key elements involved). Also, it would be helpful to ensure that the analysis undertaken for each country

employs uniform assumptions concerning key world economic variables, including, for instance, the future level of world interest rates (as a guide to the terms of new borrowing for each member), 1/ inflation, and the rate of growth in world trade. In determining the appropriate medium-term assumptions for these variables, it is suggested that the staff rely, to a large extent, on the information underlying the medium-term assumptions provided in the most recent "medium-term scenario" exercise of the World Economic Outlook. Since these assumptions constantly change in the light of actual events (as of course do the appropriate assumptions to employ for each individual country), it would normally be expected that the debt scenario analysis would be subject to revisions on each occasion it is undertaken.

(ii) Policy implications

With the above technical scenario as background, the staff would seek to review jointly with the authorities the range of current targets which might be viewed as consistent with maintaining the debt service burden within appropriate bounds. When reviewing the latter aspect, attention would be paid inter alia to the evolution of lenders' perception of the member's borrowing capacity as indicated by changes in the average terms (vis-a-vis market trends) obtained on new loan commitments. In turn, the adequacy of domestic policies aimed at influencing movements in exports and imports so as to achieve a desired external sector outcome can be assessed. The analysis of policies can be cast in terms of other macroeconomic variables; thus, given a desired external current account outcome, a targeted level of economic growth (domestic investment) will determine a maximum level of domestic expenditure (a minimum level of domestic savings).

While these improvements in information and in the underlying technical analysis will serve to both broaden and deepen the external debt surveillance content of the consultation process, it should be emphasized that an adequate appraisal of external debt policy must inevitably involve substantial judgmental elements. In particular, any tendency to rely mechanically on one or more debt indicators to provide clear-cut answers should be avoided. This is especially the case in view of the sensitivity of any "forward-looking" analysis of the kind described to the particular assumptions employed. The wide variety of uses for which external borrowing operations may be undertaken (for example, for investment purposes, to shelter consumption from internal or external shocks, or to reduce the costs of adjustment) has given rise to many alternative theoretical approaches to the question of the optimal or sustainable level of foreign borrowing. Since, ultimately, it is the efficiency of the use of foreign savings by the

1/ A normal procedure (unless there were specific reasons to do otherwise) might be to assume that the relationship between the member's borrowing terms and the average market terms which prevailed in the most recent period would hold in the future.

borrower which determines the sustainable scale of external financing, it is well recognized that the sustainable level of recourse to foreign savings differs widely among countries. Moreover, numerous features of international financial markets, including the possibility of sudden and sharp fluctuations in lenders' perceptions of whether countries' borrowing policies are sustainable, play at times a critical role. These considerations tend to rule out any universally applicable formula for judging the sustainability of a particular debt situation.

Nevertheless, the implementation of external debt management policies requires policymakers to make judgments taking into account these difficult and uncertain elements. The proposals for increased emphasis on external debt issues in the consultation process will help the Fund, in consultation with the member, to arrive at a considered and balanced assessment of the member's policies in this area. Thus, *apart from ongoing efforts to improve the comprehensiveness of the* coverage of recent external debt developments, the improved procedures suggested above will provide an explicit forward-looking framework, prepared in close consultation with the authorities, for reviewing external debt policy. Against this background, the staff would seek the authorities' assessment of the consistency of their policies and targets with maintenance or achievement of a sustainable external debt position; in turn, the staff appraisal would contain a commentary on the authorities' views. This material would provide a basis for the ensuing Executive Board discussion and for that part of the Chairman's summing up dealing with external debt policy.

4. Cooperation with commercial lenders and supervisory authorities

A contributing factor to the present debt servicing difficulties has been the excessive swings which have occurred in the volume of foreign lending by banks with international exposures. While such fluctuations are due to a number of causes, one reason lies in the fact that during recent periods many banks had available only incomplete or out-of-date information concerning a borrowing country's actual economic and financial situation. In such circumstances, there was a tendency for lending activities to continue on a relatively large scale close to the point when a "crisis" emerged, at which time lending operations were abruptly reduced or terminated. In order to help prevent this type of situation from developing in the future, private lenders have recognized *the importance of improving the quality and availability of* information concerning borrowing countries' economic performance. To that end, commercial banks are establishing a new Institute of International Finance (Ditchley Institute) which would act as a clearing house for debtor-country information.

So far as information relating to the Fund's activities with member countries is concerned, the Executive Board has taken the position that documentation dealing with Article IV consultations (including staff reports on Recent Economic Developments, and the Chairman's summing up) is not to be made available by the Fund to private commercial banks.

This decision was based mainly on the need to preserve the confidential nature of the discussions between the member and the Fund. It is also felt desirable to avoid situations where the release of information with judgmental content might induce speculative capital movements and impede orderly adjustment efforts by the member. In present circumstances, the staff believe that the above policy relating to disclosure of Article IV consultation information to commercial banks remains appropriate, as the Fund must continue to ensure confidentiality in its discussions with members. In this connection, it should be noted that commercial banks themselves are in a position to seek information directly from the authorities of a borrowing country when this is felt to be an important requirement for decisions concerning their lending activities and the Institute of International Finance is expected to be active in this field.

All Fund members have an interest in ensuring that decisions by private lenders are based, to the greatest possible extent, on objective, comprehensive and current information concerning the economic circumstances of borrowing countries. For this reason, in the staff's view, the Fund should be prepared to make publicly available in a readily accessible form the detailed series contained in the Bureau of Statistics' Data Fund, on which the published statistics in International Financial Statistics are based. However, access to data series of a confidential nature would not be permitted. Also, the Fund should be prepared, if requested by a member, to assist that member in the preparation of specific statistical material which the member might want to put at the disposal of the Institute of International Finance. Finally, the staff could exchange views with the Institute on the most appropriate way to undertake creditworthiness analysis.

In addition, contacts between the Fund and national banking supervisory authorities on matters of common interest will continue on an informal basis. As one aspect, the enhanced external debt information and analysis in Article IV documentation will assist domestic central banks and supervisory authorities in the exercise of their regulatory functions relating to commercial lending activities within their jurisdiction. More generally, it is expected that an exchange of views with supervisory authorities regarding their approach to the provision of closer guidance to banks with respect to cross-border lending will be especially useful. The Fund would be willing to collaborate with the supervisory authorities in their endeavors to increase the supervisory role in country risk matters.

V. External Debt Issues in the Context of Use of Fund Resources Programs

The recent intensification of external debt servicing difficulties has been an important factor underlying the rise in the number of members seeking to enter into financial arrangements with the Fund and the increased amounts involved. However, the types of problems raised

have varied considerably among members, often depending on the stage at which Fund assistance is sought. Thus, in many instances, members' debt servicing problems have become so severe that ensuring adequate capital inflows consistent with the implementation of a viable adjustment program is of paramount importance. For other members, while their external financing difficulties are not necessarily at an acute stage, a central aspect of the adjustment effort embodied in a Fund-supported program is to ensure that debt management policies are consistent with the medium-term debt servicing capacity of the economy.

The first part of this section reviews the role of the Fund with regard to the provision of extraordinary balance of payments financing, and the relationship of the latter to the design of Fund-supported adjustment programs. The second part addresses several issues arising from experience with the 1979 guideline with respect to foreign borrowing in use of Fund resources programs.

1. The provision of adequate external financing and and design of adjustment programs

a. The Role of the Fund

In helping to devise an adjustment program for countries facing severe balance of payments difficulties, the Fund has always needed to ensure that the program's external targets are consistent with the available amounts of net external financing, in other words, that the adjustment program to be supported by the use of Fund resources is a viable one. For example, in some situations, the Fund has sought to guard against the possibility that an infusion of resources from the Fund does not simply substitute for a withdrawal of funds by other creditors, a development which could seriously jeopardize the adjustment effort. For some of the countries concerned, an important aspect of their efforts to obtain adequate external resources may involve seeking a rescheduling of some of their external debt obligations. As described in more detail in Section III, the number and overall significance of both official and private debt reschedulings has risen very sharply in recent periods.

In view of the increased importance of debt rescheduling (or other forms of exceptional balance of payments financing provided by creditors) in devising an adjustment strategy, the Fund management and staff, on several occasions, have played an important role in facilitating discussions between the debtor country and the creditors involved. This cooperation has taken several forms. In some instances, where the authorities believed they were not well positioned to approach their private commercial bank creditors, the Fund staff, concerned that continued inaction would severely complicate efforts to address the problems, took the initiative in bringing the parties together for initial discussions. Also, on occasion, with the approval of the debtor country concerned, the staff have acted as a conduit for the exchange of information between the parties involved; in addition, the staff

sometimes have provided technical assistance to the debtor country in preparing statistical documentation for its negotiations with creditors. More generally, where requested by both sides, the Fund staff have sought to facilitate the discussions by providing an objective analysis of the current situation as well as the near and medium-term prospects of the economy. In situations where the continued implementation of an agreement between lenders and the debtor country was conditional on compliance with performance tests under Fund arrangements, the Fund has provided documentation to the debtor country which could be made available to its creditors indicating performance under the arrangement.

The Fund's initiatives were, however, not restricted to situations involving existing individual country debt servicing difficulties. There were instances where the perception of regional risk has added to banks' assessment of the risk of cross-border lending in general. Countries were finding their access to capital markets restricted without any significant change in their underlying economic situation, mainly due to the emergence of debt servicing difficulties in neighboring countries. In these situations, at the request of the authorities, Fund staff have acted as a conduit of information between the countries and their creditors in an effort to help ensure that market sentiments be guided by more reliable and complete economic information.

Frequently, the Fund staff have explained in some detail to official and private creditors the implications of the domestic adjustment efforts proposed by the authorities. In several instances, the staff have indicated that, on the basis of these adjustment efforts, there would nevertheless remain an external "financing gap" during the period of the proposed Fund-supported program. In many of these cases, such a gap has been filled by the subsequent actions of creditors in providing debt relief or other forms of exceptional financing to the country concerned. In one recent instance (Sudan), an external finance coordinator has been appointed jointly with the IBRD, with the full consent of all parties involved, in order to help coordinate and harmonize the terms of debt restructuring between various groups of creditors in a way that is consistent with the debtor's capacity to meet the repayment terms. However, in other situations, the amount of financing provided by creditors may fall short of the amount needed to fill the existing gap. In these circumstances, in order to preserve the viability of their adjustment program, the authorities may need to implement additional policy measures. To take account of these possibilities in such situations, the Fund has generally provided in the arrangement with the member, various safeguards (which are described in Section V.1.b, below) which are intended to ensure that Fund resources are provided to members only when there exist reasonable assurances that there is a viable adjustment program in place. On occasion, however, serious problems have arisen when the discussions between bank creditors and the debtor become protracted. In such cases, a difficult decision has been required as to whether the member's request for use of Fund resources should be presented to the Executive Board while discussions between the parties continue. Usually, the member's request for use of Fund

resources was presented to the Executive Board when the member could be judged to be making a serious effort to reach agreement with private creditors involved. During the continuing negotiations, it is important that the Fund continue its stance of neutrality, e.g., the member concerned would not be placed in the position of having to accept whatever terms were sought by the private lenders, such as a requirement that the authorities would assume losses incurred by private sector debtors.

The above approach has generally proven to be effective. In the staff's view, it continues to be the appropriate normal policy response in such circumstances. However, in the recent past, there have been a limited number of situations where the Fund has assumed a more direct coordinating role than has normally been the case. The emergence of debt servicing difficulties for certain major debtors has led to a situation where failure to address quickly their liquidity problems would have had potentially adverse implications, not only for the success of their own adjustment efforts but, more broadly, for the stable functioning of the international financial system. This danger arose because of the possibility that in the present uncertain lending environment, a lack of banking confidence stemming from unresolved problems of one or two major debtors might spread to other debtors in a manner which could prove difficult to control. In view of these considerations, there was a need for prompt action to address the debtors' financial and liquidity problems, and the Fund proved to be in a unique position to coordinate effectively the responses of the parties involved. In particular, Fund management and staff, in addition to playing their traditional role of explaining to lenders the implications of the adjustment efforts which the authorities had succeeded in implementing, also stressed the importance, in concert with major creditors, of ensuring sufficient additional net external financing in support of these efforts. Moreover, in view of the urgent need to promptly put in place an adjustment program which was perceived as viable and at a time when Fund initiatives can be most effective, Fund management indicated that support from the Fund for the member was conditional on receiving from creditors prior explicit assurances concerning their lending activities in the period ahead. In the case of inflows from commercial banks, through interaction with bank steering committees, written commitments were obtained regarding the maintenance of existing exposure as well as new amounts of medium-term financing. In these latter instances, the positive attitude taken by a number of domestic bank regulatory authorities toward an increased exposure of banks within their jurisdiction vis-a-vis the debtor countries having programs with the Fund is noteworthy.

The above Fund initiatives represented a timely and effective response to the exceptional situations which arose in the recent past. Moreover, they have been broadly welcomed by the international financial community, as well as by the debtor countries concerned. In particular, the risks of the emergence of a contagious lack

of confidence will lessen if the efforts presently under way to deal with the problems of major debtors prove to be successful. In these circumstances, it would not be appropriate to seek to formalize any general policy criteria concerning the precise role of the Fund in such situations. If and when further difficulties of this nature were to arise, they would continue to be handled on an individual case-by-case basis, in close consultation with all parties concerned and keeping Executive Directors fully informed of the possible alternative courses of action under consideration.

b. The design of adjustment programs with ex ante financing gaps

As noted earlier, an operative stand-by arrangement with upper credit tranche conditionality has become the prerequisite for the conclusion of official multilateral debt renegotiations. In addition, such an arrangement has recently been associated with debt restructuring and new lending from private creditors. This growing interdependence, combined with the complexities involved in debt restructuring exercises and the uncertainties in the scale of other additional financing, has given rise to certain practical complications in the overall design of a Fund-supported adjustment program and the formulation of performance criteria. In certain cases the adjustment strategy underlying Fund-supported programs has been designed under uncertainties concerning prospective debt relief and related financing and, consequently, the financial program may entail an ex ante financing gap. As explained in the preceding section, however, the Fund must be assured that the gap will be filled either by provision of sufficient additional external financing or further adjustment efforts by the member in order for the program to be viable. This section reviews approaches adopted to this question in the 27 programs associated with debt relief since 1980, and discusses certain policy issues that have arisen.

(i) Recent experience

In the case of countries under a severe financing constraint and which have sought debt renegotiations, the preferred approach to incorporating the availability of foreign financing is to formulate the adjustment program when the outcome of the renegotiation is reasonably assured. However, in practice, this approach has not proved feasible since an arrangement with the Fund has either become a prerequisite for, or preceded, a debt rescheduling. To resolve this impasse, the adjustment program in these cases has been designed on the basis of certain 'working' assumptions concerning the overall scale and timing of the debt relief and/or exceptional finance expected to fill the financing gap.

In such instances, it has been necessary to incorporate safeguards (described below) into programs, since it is quite likely that there will be divergences between the expected and actual amounts of exceptional financing resources received. In the case of debt relief, these divergences are due to several factors, including deficiencies in the

debt data base involving substantial under-recording, uncertainties regarding the type of debt that would be eligible for rescheduling as well as the average terms to be obtained, and, finally, unforeseen delays in the conclusion of the various agreements involved (including the bilateral agreements required to implement the multilateral agreement).

Reflecting the above uncertainties, for most of the arrangements under review, performance criteria were formulated for only a part of the program period. 1/ As a corollary, almost all programs (and, indeed, 13 out of 14 arrangements approved since 1982) provided for a review (at the latest by mid-year) in order to reach necessary understandings about future policies and performance criteria. In addition to this standard provision, further safeguards have been incorporated to varying degrees depending on the extent of the uncertainties and the nature of the financing difficulties. In four instances [Madagascar (1982), Sudan (1982), Mexico (1982), and Argentina (1983)], the member's request for use of Fund resources was considered by the Executive Board only after assurances had been received from special official balance of payments aid groups or from private creditors that a defined minimum amount of additional external financing would be forthcoming. In two other instances (Romania, 1982, and Sudan, 1983), the review clauses explicitly linked further purchases under the program to the Fund being satisfied with the outcome of the various prospective reschedulings. In fact, in the case of Sudan, the arrangement, although approved by the Executive Board, would not actually go into effect until the Fund concluded that satisfactory arrangements had been made for a global and comprehensive rescheduling consistent with the economy's medium-term debt servicing capacity. If delays occurred, a special early review would re-examine several aspects of the program.

For most arrangements, the formulation of performance criteria relating to domestic credit expansion followed the conventional form, as it was not generally found feasible to make advance provision for the actual amount of debt relief that might be granted. There were only 3 instances 2/ where the linkage between debt relief and domestic credit to the government was considered sufficiently firm for the provision of automatic adjustments in the relevant ceilings. Regarding the performance criteria relating to external borrowing, all arrangements followed the long-standing practice of excluding refinancing loans obtained in the framework of multilateral debt rescheduling (see Section V.2).

The formulation of performance criteria on external payments arrears showed more variation as, to the extent possible, account was taken of

---

1/ Selected features (relating to debt relief) of the performance criteria employed are summarized in an annex to the "Background Information" paper for 27 arrangements that were associated with debt rescheduling since 1980.

2/ Malawi (1982), Senegal (1982), and Senegal (1983).

the amounts of payments arrears expected to be rescheduled. 1/ However, the precise timing of the various renegotiations aimed at regularizing arrears proved difficult to forecast and, as a result, most arrangements did not specify whether the programmed arrears reduction was to be achieved through rescheduling or net cash payments. 2/

The performance record of the above arrangements is mixed. For 8 of the 27 arrangements reviewed, performance criteria were not observed. However, as discussed in detail elsewhere, 3/ such breaches are frequently attributable to a combination of factors, both exogenous and domestic, and it is noteworthy that, for the cases under review, deviations from assumptions concerning debt relief and other exceptional financing have not been cited as a major contributing factor to deficient program performance.

(ii) Suggested approach

In spite of the difficulties outlined above, given the existing institutional arrangements, there is no satisfactory alternative to the present approach of designing adjustment programs in advance of firm knowledge of how any *ex ante* financing gap is filled, including the terms and amount of debt relief expected. However, there is scope for strengthening the technical aspects of program design in light of the extensive recent experience. Thus, for countries that have previously undertaken reschedulings, it would be prudent to usually assume that the outcome of any further debt relief negotiations would be broadly similar to that obtained previously. For countries which have requested debt relief for the first time, a standard procedure would be to assume the average terms that have recently been granted to countries in similar situations (see Sections III.1 and III.2, above). However, in view of the types of problems noted above, the staff should, in all cases, provide information regarding the external financing that may be required to ensure the viability of the adjustment program submitted by the

1/ For a more detailed description of the aspects concerning external payments arrears, see "External Payments Arrears of Fund Members, 1981-82," (EBS/83/12, 1/12/83).

2/ For the 12 arrangements where quarterly arrears reduction targets were specified, 5 arrangements formulated the targets only in terms of net cash payments; 6 arrangements did not make a distinction between the means of arrears reduction, i.e., whether through rescheduling as opposed to net cash payments. In only one instance (Uganda, 1982), were the targets specified for both rescheduled arrears and net cash payments.

3/ "Review of Recent Extended and Upper Credit Tranche Stand-by Arrangements," (EBS/82/97, 6/9/82).

authorities: this magnitude should be clearly identified in the balance of payments as an as yet unfinanced gap and, if relevant, in the government budget. 1/

As far as the formulation of performance criteria is concerned, given the diversity of circumstances present, it is difficult to prescribe a unique "first best" approach to the technical complications arising from uncertainties relating to prospective debt relief and other exceptional financing. However, in the staff's view, the approach adopted should be based on two principal considerations: first, it is necessary to avoid ambiguous and/or ineffectual program monitoring devices; and, second, it is important that the neutral role of the Fund in the debt renegotiating process be safeguarded. The first consideration is related to the possibility that substantial deviations in the outcome (from the assumed values) would render the prespecified ceilings more relaxed or restrictive than intended. The second consideration involves avoiding the impression that the Fund predetermines the terms and conditions of the debt rescheduling that may have been assumed for the purpose of designing the adjustment program.

In light of these considerations and the experience so far, the staff believe it is generally appropriate to formulate quantitative performance criteria only for that part of the program period where major variables will not be affected by the outcome of the debt relief discussions. Generally, a mid-year (or earlier, if necessary) review clause should be provided in order to reach policy understandings as necessary and to formulate corresponding performance criteria in light of the actual outcome for debt relief. This approach should be standard in most circumstances where there is less likelihood that the deviations will significantly alter the nature or degree of the required adjustment effort (although that possibility cannot be ruled out). In particularly difficult and uncertain situations, in the staff's judgment, "effective" implementation of the arrangement should await the resolution of these uncertainties (Sudan, 1983); such an approach, however, would be adopted only in a quite limited number of exceptional cases.

Finally, a phased reduction in, and, if feasible, elimination of, all external payments arrears is an essential element in Fund-supported programs. In multilateral negotiations, considerable uncertainties are often present concerning the timing and extent of rescheduling of arrears owed to creditors, in particular, those relating to private suppliers' credits. In view of these uncertainties, it could be expedient in some cases to focus on a phased reduction by means of net cash payments for those arrears that are not the subject of the multilateral

---

1/ The presentational aspects of debt relief have varied among programs. As illustrations of recent cases where these flows have been explicitly accounted for, see Madagascar (EBS/82/103, 7/11/82), Turkey (EBS/83/17, 1/21/83), and Uganda (EBS/82/25, 7/13/82).

rescheduling. This coverage for arrears would be analogous to the approach adopted in the case of external debt ceilings whereby multilateral debt relief has traditionally been excluded.

2. Review of 1979 guidelines on performance criteria with respect to foreign borrowing in use of Fund resources programs

The guideline on the use of performance criteria with respect to foreign borrowing in programs supported by the use of Fund resources (adopted in July 1979), states inter alia that "when the size and the rate of growth of external indebtedness is a relevant factor in the design of an adjustment program, a performance criterion relating to official and officially guaranteed foreign borrowing will be included in upper credit tranche arrangements" (EBM 79/121, 7/23/79). 1/ This section reviews experience with the above guideline and discusses certain policy issues which have arisen in connection with its use.

a. The rationale for external debt ceilings in adjustment programs 2/

Fund-supported adjustment programs aim at restoring and maintaining a sustainable relationship between aggregate supply and demand in order to achieve the objectives sought with regard to the level of domestic activity, prices, and the balance of payments. The macroeconomic adjustment program, therefore, requires that total financial flows--from both domestic and foreign sources--be consistent with the level of aggregate demand that is compatible with these objectives. Thus, from the point of view of financial programming, ceilings on external borrowing can be viewed as a logical supplement to ceilings on domestic credit. The case for limiting financing from both domestic and external sources is particularly strong in the case of the public sector where, experience has shown, most external debt problems have their roots.

The above considerations relate to the context of a single period analysis of the economy. However, from an intertemporal perspective, the use of foreign borrowing in any given period permits a level of domestic expenditure higher than it would otherwise be. Seen in the light of the objective of achieving a sustainable balance of payments over the medium term, the problem then becomes one of assessing whether a future stream of real resources can be generated which is sufficient

1/ The text of the guideline (which in the discussion which follows is taken to include the understandings contained in the Managing Director's summing up of the discussions in the Executive Board) is reproduced as an Annex to this paper.

2/ For a fuller discussion, see "External Debt Management Policies," (SM/79/125, 6/6/79). The topic is also dealt with in "Adjustment Programs--Broad Design and Key Indicators," (EBS/82/98, 6/9/82), and in various recent papers reviewing overall experience with stand-by arrangements and extended arrangements.

to permit the eventual repayment of the foreign liabilities incurred. In the case of external borrowing designed to finance investment, care needs to be taken to ensure that the productivity and efficiency of the capital expenditures involved are adequate in relation to the external borrowing cost. Moreover, the availability of additional foreign savings to finance investment could coincide with a reduction of domestic savings and a diversion of resources to maintain unsustainable levels of consumption. Also, even in cases where debt has been contracted to finance profitable investment, debt servicing difficulties could still emerge because of a mismatch between the maturity profile of the debt and the availability of foreign exchange earnings.

The present guideline on external debt limitations in adjustment programs is designed to ensure that for countries experiencing balance of payments difficulties, appropriate criteria for foreign borrowing are formulated consistent with a desired relationship between aggregate demand and supply and a sustainable borrowing path over the medium term. The guideline noted that while the criterion will normally be formulated in terms of loans contracted or guaranteed, in appropriate circumstances it may be formulated in terms of disbursed debt. In view of experience suggesting that in developing countries imbalances in the public sector are often a major contributing factor to an overall unsustainable external position, the guideline indicates that "normally, the performance criteria will relate to official and officially guaranteed borrowing." 1/ In certain circumstances (those where the member's external management policy covers private debt and where established regulatory machinery to control such borrowing is in place), coverage may be extended to include private sector borrowing without official guarantee.

The guideline states that the criterion will include foreign loans with maturities of over one year with the upper limit being determined by conditions in world capital markets; at the time the guideline was adopted, the upper limit was set in the range of 10 to 12 years. In general, a subceiling on loans with maturities of over one year and up to five years would also be included. While loans of less than one year maturity would normally be excluded from the borrowing limitations, in exceptional circumstances where nontrade-related loans of less than one year become a source of difficulty, such loans would be included. Finally, to ensure that capital inflows of a concessional nature are

1/ In circumstances where external debt per se is not a matter for concern, but programs have as a main objective to reduce aggregate demand and budgetary pressure, the guideline provides that the credit ceiling for the public sector cover both domestic and foreign financing sources.

not discouraged, the guideline excludes from the coverage of performance criteria "loans defined as concessional under DAC criteria, where sufficient data are available." 1/

b. Experience with the use of debt limitations in upper credit tranche stand-by arrangements and extended arrangements 1979-82 2/

(i) General characteristics of the use of performance criteria relating to foreign borrowing

During the period 1979 through 1982, of the 118 distinct annual programs presented to the Executive Board under upper credit tranche stand-by or extended arrangements, 110 programs contained a separate performance criterion related to foreign borrowing. The few instances where such a criterion was not present included those in which an overall ceiling on public sector borrowing (from both domestic and foreign sources) was used instead, or those where the external debt position was not viewed as a relevant factor in the design of the adjustment program. The near universal applicability of the criteria during this period contrasts with earlier experience: during the period 1973-1978, only two thirds of upper credit tranche stand-by arrangements contained an external debt limitation as a performance criterion.

The main characteristics of the performance criteria which were variously employed are summarized in Chart 1. Almost 95 per cent of programs provided for a limit on debt incurred by the public sector. In 80 per cent of the programs, the ceiling related to contracting or guaranteeing of external debt; however, in a significant number of cases the ceiling was set in terms of the disbursed debt of the government or public sector (mainly in Central American or Latin American countries), or total disbursed debt irrespective of sector (principally in the case of programs for Eastern European countries); there was some tendency for the more frequent use of disbursement ceilings in 1981-82

1/ According to the DAC criterion, concessional loans are those with a grant element in excess of 25 per cent on the basis of a 10 per cent rate of discount. From this definition, the maximum interest rate a loan can have for a given maturity and grace period, consistent with the DAC criterion of concessionality, can be derived; these series are shown in an annex to Part III of the "Background Information" paper. It may be noted that the choice of the discount rate will significantly affect the calculated value of the grant element. The higher the rate of discount used, the closer the grant element will be to 100 per cent; when the discount rate equals the interest rate of the loan, the grant element will be zero, and it will turn negative when the discount rate drops below the interest rate.

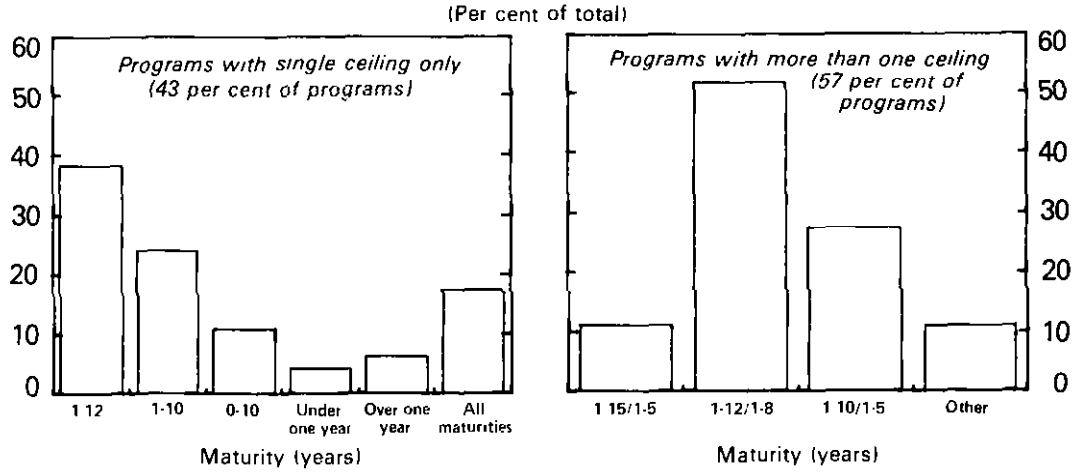
2/ Part III of the "Background Information" paper provides a detailed review of the subject matter of this section; the appendix also describes the approach taken to external debt policy in first credit tranche stand-by arrangements.

CHART 1

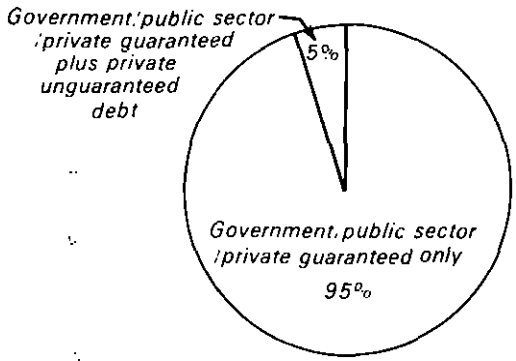
SELECTED CHARACTERISTICS OF PERFORMANCE CRITERIA RELATING TO EXTERNAL DEBT IN FUND SUPPORTED PROGRAMS, 1979-82

A. MATURITY STRUCTURE

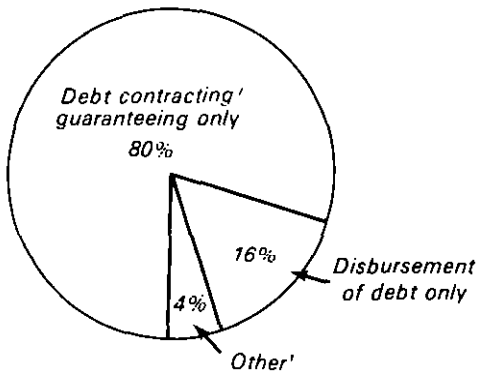
(Per cent of total)



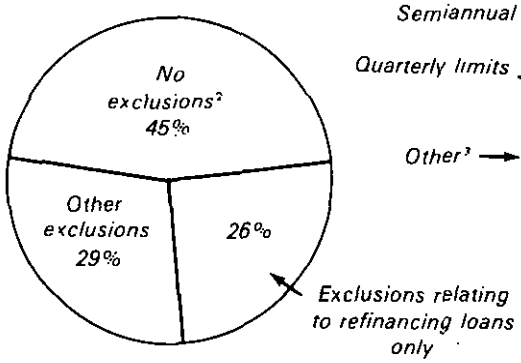
B. SECTORAL COVERAGE OF BORROWER



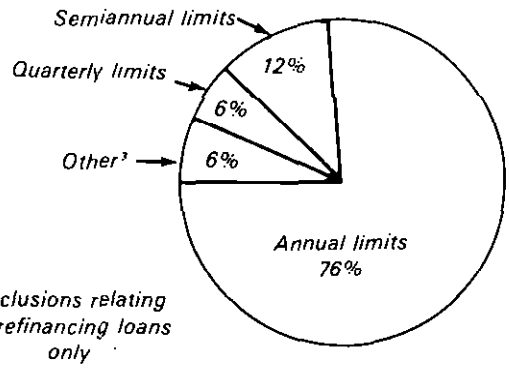
C. FORM OF CEILINGS



D. EXCLUSIONS FROM CEILINGS



E. TIMING OF PERFORMANCE CRITERIA



Source: SM 83 46 3-9-83 Part III

[1]Refers to programs which contain ceilings on both the contracting and disbursement of external debt.

[2]Other than concessional loans and purchases from the Fund

[3]Refers to programs containing some combination of annual semiannual/quarterly ceilings

compared to earlier periods. 1/ The ceiling in about three quarters of the program was set at a single annual limit; most of the instances where semiannual or quarterly limits were employed involved use of the disbursed debt approach and were closely linked to expected intrayear movements in public finance or external current account variables.

In about 60 per cent of programs containing only one overall ceiling (43 per cent of all programs), the maturity coverage of the ceiling was concentrated in the range between 1 and 10 to 12 years. Where subceilings were employed, the most commonly used maturity combination was 1-12/1-5 years or 1-10/1-5 years, although a number of programs involved different maturity variants. Coverage of short-term (i.e., of under one year maturity) debt was included relatively infrequently, in 22 out of 110 programs; as in the case of ceilings on disbursed debt, the inclusion of short-term debt (which occurred most frequently in Central American or Latin American programs) became somewhat more common in the recent past, especially in 1982. 2/ Of the 22 programs, however, only four provided for a specific limit on short-term debt only.

Apart from the exclusion of concessional loans from the coverage of the performance criterion, just over half of the programs involved other exclusions. The most common additional exclusion involved different types of restructuring or refinancing loans; in some instances, the excluded loans were defined as those associated specifically with debt rescheduling exercises envisaged as part of the adjustment program, while in others, the nature of the refinancing loans involved or the context in which they might be obtained was not specified. The other exclusions covered a wide range of loan types; in some cases, the staff explained that there was considerable uncertainty present as regards the timing of the contracting/disbursement of the loan as well as the amounts that might be involved.

Finally, during the three-year period 1979-81, the performance criterion relating to external debt limitations was not observed on relatively few occasions, in 7 out of 68 programs. The average mean rate of utilization of the debt ceiling was about 55 per cent in the case of the overall ceiling and either 0 or 35 per cent (depending on whether the mean or the median is considered) for the subceiling. In a significant number of programs, zero debt was contracted (especially in the subceiling maturity range) although very few programs had specified a zero limit for the ceiling itself.

1/ It may be noted that the recent programs for Argentina and Brazil submitted to the Board in early 1983 both employed the disbursement approach.

2/ In addition, the 1983 programs for Argentina and Brazil already referred to provide for external borrowing limitations which include short-term debt.

(ii). Trends in selected debt indicators for program countries

As a background to considering the possible overall impact of ceilings on foreign borrowing, it is useful to examine comparative trends in selected debt indicators of members during the period in which they adopted programs. In the case of programs approved during the period 1979-81, there was on average a marked tendency for the rate of growth of total outstanding (including undisbursed) debt other than from multilateral sources to slow down sharply (Chart 2). This trend was especially noticeable in the case of debt owed to private creditors, the rate of growth of which for all programs on average declined from an annual average rate of 18 per cent in the three-year period prior to the program to 1 per cent during the program period. Correspondingly, there was a decline during the program period, in the proportion of total new commitments accounted for by loans from private creditors. However, the average maturity of total new commitments tended not to have changed to any significant extent and the mean interest rate on new commitments for the program group on average rose by about one percentage point.

It cannot be concluded necessarily, however, that the above trends reflected the restraining impact of the debt ceiling itself, since factors influencing the supply of funds may also have played an important role; for example, a slowdown in the rate of increase in debt may have partly reflected a general increased reluctance on the part of lenders to lend to developing countries. In addition, for program countries, unwillingness on the part of lenders is likely to have been more marked--a situation consistent with the general tendency to utilize on average significantly less than 100 per cent of the programmed debt ceilings. The evidence summarized in Chart 2 suggests that insofar as the indicators relating to total nonmultilateral debt and the average terms of new commitments are concerned, trends for the program group on average tended to mirror those experienced by non-oil developing countries in general. However, the reduction in the rate of growth of private debt as well as in the relative share of commitments from private sources observed in program countries appears to have been much more marked than that for all non-oil LDCs.

No inferences should be drawn from the above highly aggregative information as regards the outcome experienced by any individual member. However, considering the entire program country group, the program period appears to have been associated with a significantly reduced emphasis on recourse to nonconcessional debt. In some instances, this outcome is likely to have been influenced by the restraining effect of the external borrowing ceiling. However, the generally low rate of utilization of the ceilings, as well as the fact that qualitatively similar trends were experienced by other countries during corresponding time periods, suggests that lender attitudes toward non-oil developing countries in general and the program countries in particular also played an important role.

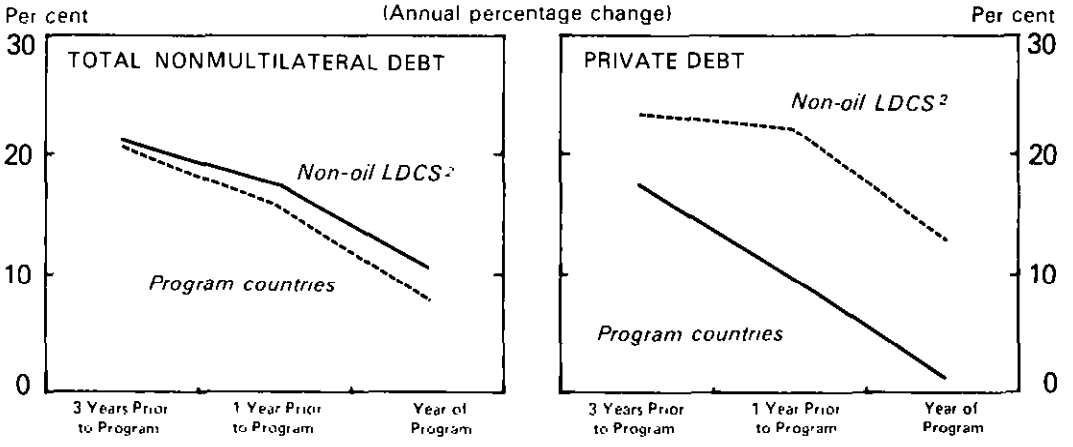
CHART 2

SELECTED DEBT INDICATORS FOR COUNTRIES WITH UPPER CREDIT TRANCHE CONDITIONALITY PROGRAMS, 1979-81

(Average of all programs[1])

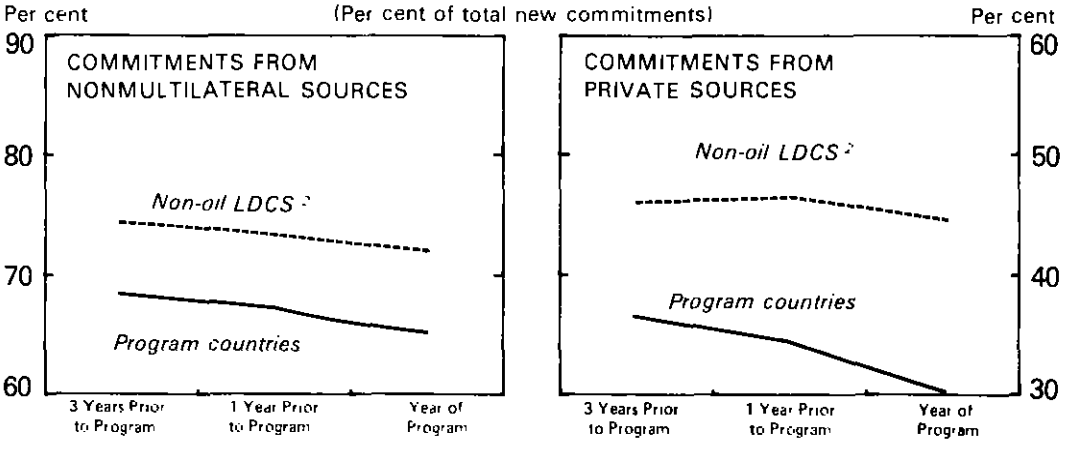
A. RATE OF GROWTH OF OUTSTANDING DEBT

(Annual percentage change)

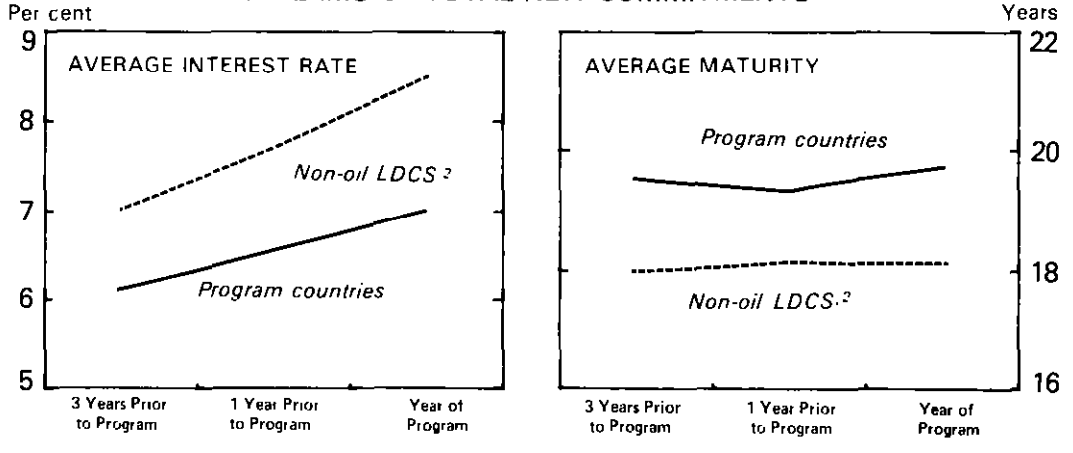


B. STRUCTURE OF NEW COMMITMENTS

(Per cent of total new commitments)



C. TERMS OF TOTAL NEW COMMITMENTS



Source: SM 83/46, 3-9-83, Part III

[1]Reflecting data availabilities, coverage of programs differs depending on the indicator.

[2]Non-oil LDC data constructed as a weighted average of data for three country groups: low income Africa, low income Asia, and middle income oil importers, with the weights equal to the distribution of program countries within each country group.

c. Policy issues

The guideline on performance criteria relating to foreign borrowing has played a useful role in the design of upper credit tranche adjustment programs. Since its adoption, it has become virtually standard practice for a separate external debt ceiling to be included in programs. In the relatively few instances where such a ceiling was not specified, the program generally provided instead for an overall ceiling on the public sector deficit, including borrowing from both domestic and foreign sources. In present circumstances where external debt problems per se are a significant aspect of the balance of payments difficulties generally faced by members seeking Fund assistance, the absence of a separate external borrowing ceiling in programs is likely to be, and should be, an even less frequent occurrence.

This section reviews in turn several areas in which experience with the implementation of the guideline has given rise to a number of issues: 1/ (i) the use of ceilings relating to disbursed rather than contracted debt; (ii) the sectoral coverage of the borrower; (iii) the presentational aspects of debt analysis provided in staff papers supporting requests for arrangements; (iv) the appropriate maturity range for debt ceilings and, in particular, the treatment of short-term debt; and finally, (v) the circumstances in which it is appropriate to exclude certain types of debt (other than debt on concessional terms) from the coverage of the performance criterion.

(i) The use of ceilings relating to disbursed rather than contracted debt

Experience with program formulations in recent periods indicates an increased use of ceilings on disbursed (rather than contracted or guaranteed) external debt. An advantage of the contracting/guaranteeing approach is that it enables all future external liabilities entered into during the program period to be monitored. Also, for some members, it could prove difficult to accurately monitor certain categories of loans (for example, in kind project loans, or private loans with government guarantees) on a disbursed basis. However, in many situations, there are significant advantages from the point of view of programming in employing a disbursement approach so as to establish a close link between demand management policy variables such as, for example, the overall public sector deficit and the associated financing flows, i.e., credits obtained from domestic and foreign sources. This is especially likely to be the case in the present circumstances where actual or potential external debt difficulties are severe for many members and

1/ A number of technical issues which relate to the special characteristics of certain external borrowing operations are discussed in an annex to Part III of the "Background Information" paper; the topics dealt with therein include unconventional borrowing terms, leasing, debt in nonconvertible currencies, and set-aside arrangements.

there is a need to monitor debt developments closely. A disbursement approach also avoids problems associated with refinancing loans which may need to be excluded from contracting limits (see (v) below). Moreover, the degree of flexibility often present as regards the timing of the formal signature of a loan can serve to lessen the effective degree of restraint implied by a contracting ceiling.

Given the above considerations, in the staff's view, there normally would exist a presumption in favor of utilizing the disbursement approach. Logically, a disbursement ceiling should include all forms of external borrowing, including concessional loans, in order to be consistent with the net external inflows which have been assumed in projecting, for example, the public sector accounts for the program period. However, bearing in mind the present guideline's reference to the importance of not discouraging concessional capital flows, it may be appropriate to exclude these categories of loans from a disbursement ceiling. If the disbursement of publicly guaranteed loans to the private sector cannot be monitored adequately, the most suitable approach would be to employ a separate contracting ceiling for such loans.

(ii) The sectoral coverage of the borrower

The practice, to date, consistent with the guideline, generally has been to include only public and publicly guaranteed debt. In some cases, this has encompassed borrowing by the official banking system. So far as privately owned banks are concerned, the case for inclusion of their external liabilities in the ceiling will depend on whether there are sufficient assurances that the authorities' use of other available policy instruments (for example, the use of limitations of guarantees in relation to capital) will ensure adequate control over this form of borrowing. In some situations where the degree of indirect control thus exercised by the authorities is not as strong as might be desired, it would be appropriate to include these liabilities in the overall ceiling or in a separate sepcific limit. The argument for this approach is likely to be particularly strong in the case of short-term liabilities of the banking system where there are potentially greater costs associated with an excessive buildup of this type of debt (see (v) below).

It is also the case that inappropriate contracting of foreign debt directly by the private sector (other than through the domestic banking system) can have adverse implications for the economy's debt servicing position. Moreover, there have been exceptional instances recently where the authorities have subsidized directly or indirectly the debt service payments of enterprises in difficulties, or have assumed their foreign debt; in such circumstances, the distinction between public and private foreign indebtedness has become somewhat blurred. In view of these considerations, the question can then be raised as to whether there is a strong case for extending the normal coverage of external debt limits to some elements of the private nonbanking sector.

However, there continue to be both practical and conceptual drawbacks involved in any widespread adoption of such an approach. In the first place, adequate procedures for monitoring on a sufficient up-to-date basis the level of outstanding private debt which has been directly contracted abroad are not available in many instances. For this category of debt, market forces, including the possibility of losses in the case of unprofitable investment, and relative price incentives (for instance, appropriate exchange rate and interest rate policies) may provide more efficient signals to private capital flows than the establishment of direct controls. In cases where governments subsidize these types of private debt operations (by, for example, providing a more appreciated exchange rate for debt service payments relating to existing debt), it may well be preferable to handle the problem by highlighting the associated costs involved and the consequent constraints implied on other government endeavors; in other words, issues of this nature perhaps could be better addressed by means of the performance criteria relating to the public sector or in the context of exchange rate policy. 1/ For the above reasons, it is felt that the inclusion in the performance criteria of private debt which has been contracted other than by the domestic banking system, should continue to be on an exceptional basis. In those circumstances where this is viewed as appropriate and necessary, the staff would outline the reasons underlying the adoption of the approach.

Finally, in cases when governments do assume private debt, these loans will then be included in the public debt ceiling and, other things being equal, compliance with the latter would require an offsetting reduction in the contracting or disbursement of other public external debt.

(iii) Presentational aspects of debt analysis in Fund programs

The external debt guideline states inter alia:

> In analyzing the amounts and terms of new borrowing that would be appropriate--in the members' circumstances--over the medium term, the staff will take into account prospective developments in the member's external payments situation and the profile of its external indebtedness.

Since the above discussion, the Board has reviewed EBS/81/152, Supp. 1 (9/1/81), which dealt with the overall presentational aspects of Fund programs. Following this review, staff papers analyzing programs submitted in connection with requests for use of Fund resources

---

1/ Care should also be taken to avoid potential fiscal problems arising from situations where the authorities provide in advance exchange rate guarantees for private debt to be contracted in the future.

have contained a more explicit analysis of the principal assumptions of the adjustment program, as well as of key behavioral relationships underlying the linkage between the targets and policies of the program.

The staff believe that it would also be appropriate for all staff papers dealing with upper credit tranche conditionality programs to contain an explicit discussion of the rationale underlying the amount of new debt provided for in the performance criterion relating to foreign borrowing. Such an analysis would be based on an assessment of the debt servicing capacity of the economy in the medium term and would be similar to that discussed in the case of Article IV consultation reports (see Section IV.3). Thus, the analysis would indicate the profile of future debt service payments based on (a) debt outstanding prior to the program; (b) debt permitted to be disbursed (or contracted, as appropriate) during the program period, of which the amount covered by the performance criterion would be identified separately; and (c) projections for new debt to be contracted in subsequent years. As was suggested for consultation reports, since the element (c) is subject to considerable uncertainty, it might be useful for the projections in some cases to be in the form of a range embodying, for example, alternative assumptions for the time path of the external current account position. 1/

(iv) Maturity coverage of debt ceilings and the treatment of short-term debt

The upper maturity limit

The debt guideline provides that the norm for the upper maturity limit of the performance criterion relating to foreign borrowing be reviewed by the Executive Board on the basis of staff papers dealing with conditions in international capital markets. In principle, the norm should be set so as to include in the ceiling balance of payments loans or project-related loans which are not on a concessional basis. At the time of the 1979 discussion, the maturities of new medium-term bank credits had shown a lengthening trend, and taking this and other elements into consideration, Executive Directors at that time decided that a range of 10-12 years would be generally appropriate. 2/

In the past several years, however, while the average maturity length has not shown any clear-cut pattern, the longest maturity length (that which is most relevant for the setting of the norm) on new medium-term bank commitments has generally continued to be in a range of

1/ Beginning in 1981, an increasing number of papers have included analysis of the type discussed. See, for example, Senegal (EBS/82/198, 10/26/82) Thailand (EBS/82/192, 10/20/82), and Turkey (EBS/82/130, 7/26/82).

2/ The longest maturity had increased from 10 years during most of 1977 to 12 years during most of 1978; in the last quarter of 1978, it had risen further to 15 years (Table 2).

12-15 years; it exceeded 12 years, for example, in all individual periods since the third quarter of 1978 except for the third and fourth quarters of 1980 and October 1982 (Table 2). The staff have also encountered situations where the maturity length of loans may have been deliberately extended to just over 12 years in order that they would not be included in the 1-12 years borrowing ceiling. In view of these factors, the staff believe there is merit in considering an increase in the upper maturity limit. One possibility, for example, would be to raise the normal upper maturity limit to 15 years. To the extent that loans from the IBRD or other multilateral development institutions fall within this maturity range, appropriate allowance would be made for these loans in formulating the borrowing debt ceiling. 1/

The treatment of short-term debt

The debt guideline also states:

> Normally, loans of less than one year maturity will be excluded from the borrowing limitations. In exceptional circumstances where nontrade-related loans of less than one year of maturity become a source of difficulty, such loans will be included in the limitations. The Managing Director will inform the Executive Directors in an appropriate manner of the reasons for including such loans in the limitation.

At the time of the 1979 discussion, it was felt by Executive Directors that normally excluding short-term debt from the coverage of the performance criterion was appropriate as there were relatively few instances of this being a source of difficulty to members. As was indicated already, overall during the period 1979-82, programs included short-term debt in the maturity range covered only infrequently. However, in the recent past, the inclusion of short-term debt has become a considerably more common occurrence, especially in the case of Central American and Latin American programs.

Recent developments in international capital markets make clear that the potential problems associated with short-term debt have become a major cause of concern. As discussed in Section II, the greater reliance on short-term debt in many instances has not reflected an increased flow of trade credits to finance an expanded volume of trade, but have been symptomatic of major underlying difficulties, such as, for instance, increased reluctance on the part of lenders to lend at

1/ At present, the maturity ranges for IBRD loans range between 15 and 20 years, depending on the category of the recipient country.

Table 2. Maturities of Publicized Medium-Term Bank Credit Commitments, 1977-82

	Maturity Length	
	Longest (In years)	Average (In years/months)
1977 (fourth quarter)	10	7/0
1978 (fourth quarter)	15	8/11
1979 I	15	8/9
II	18	9/3
III	15	7/9
IV	15	9/3
1980 I	15 1/2	8/9
II	15	7/8
III	12	7/6
IV	12	7/8
1981 I	14	8/4
II	13	7/9
III	15	7/10
IV	15	7/7
1982 I	15	7/10
II	15	6/10
III	15	7/11
Oct.	10	9/2

Source: OECD, Financial Market Trends.

longer maturities. 1/ In turn, an excessive buildup of short-term debt increases the economy's vulnerability to adverse external developments and can lead to the emergence of external financial strains which could precipitate a major liquidity crisis. Thus, an essential aspect of debt management policies embodied in adjustment programs should be to prevent an excessive buildup of short-term debt. In cases where adjustment has been unduly delayed and an excessive buildup has already occurred, policies should ensure a reduction to more manageable and sustainable levels. These considerations indicate that in most instances it will be appropriate to extend the coverage of the external borrowing ceiling to include short-term debt.

In earlier periods, the data available regarding the size of short-term debt outstanding was often limited for many member countries. However, more recently, the coverage and timeliness of data on short-term debt which are available have improved; for example, as shown in ID/83/2, data covering important categories of short-term debt are now available for 18 countries in the group of "20 major borrowers" and for 6 of the 9 selected industrial countries examined. Moreover, faced with a situation where the need to monitor short-term debt becomes a matter of some urgency, in the experience of the staff, there is considerable scope for the authorities to successfully intensify their efforts to this end.

However, it is evident that the precise categories of short-term borrowing for which data are available varies considerably between members; this was generally the case, for instance, for the data reported in ID/83/2. For example, data pertaining to trade-related credits associated with normal commercial payments arrangements can prove difficult to obtain; however, credits of this kind are unlikely to fluctuate greatly in relation to imports. On the other hand, transactions of a short-term financial nature which are bank-related, such as use of credit lines and overdraft facilities, and which are more likely to be a source of potential difficulties, can usually be monitored reasonably accurately. Another important form of short-term credit consists of export prefinancing credits, 2/ and for major commodities, the export of which is channeled through large public or private entities, a reasonable degree of coverage is likely to be available.

With regard to the category of borrowers included, short-term foreign liabilities of the public nonfinancial sector would normally be

---

1/ This point was brought out clearly in ID/83/2 which noted (p. 17) that between 1980 and 1982, according to staff estimates, short-term debt as a ratio of imports rose from about 40 per cent to 60 per cent; this rise occurred despite the fact that, for some major borrowers, short-term debt in 1982 had been sharply and involuntarily reduced following a crisis of confidence.

2/ Credits of this type consist of both preshipment credits (which are essentially forward sales of exports), and postshipment credits.

covered. So far as short-term debt contracted directly by the private nonbanking sector is concerned, data and monitoring difficulties are likely to be more severe; moreover, the same considerations discussed above in the case of medium-term debt are likely to apply. However, as with medium-term private debt, in certain circumstances, the inclusion of this category may be appropriate. In the case of short-term liabilities of the domestic banking system, as discussed in (i) above, there is a strong presumption in favor of including a direct limitation on this category of borrowing, given its importance in many situations. Where domestic banking institutions play an important role in intermediating foreign funds to the domestic public sector, major components of their net external liability position are subject to reasonably direct control by the authorities. Generally, the authorities also can exercise a significant influence over other elements of the net external borrowing position of the domestic banks (for example, their own lending activities to the private sector). Thus, in most situations, it would prove both appropriate and feasible to include limitations on net external short-term liabilities of the domestic banking system. However, depending on the overall design of the program, it may be desirable to treat some external short-term liabilities as reserve liabilities which are covered separately by a separate performance criterion relating to movements in the net foreign assets of the banking system. 1/

The above considerations suggest that the precise categories of short-term borrowing covered by a debt ceiling will tend to vary. However, as a minimum, it would generally prove desirable to include, for instance, nontrade-related borrowing by the public nonfinancial sector as well as the net short-term liability position of the banking system. In addition, where for unavoidable reasons some debt categories have to be excluded for the present, it would be important for the staff to indicate the steps the authorities are taking to resolve these shortcomings, so as to prevent unplanned borrowing operations from threatening the implementation of the programmed adjustment.

Concerning the appropriate form of the ceiling, the general approach should be to set a ceiling on the net stock of debt outstanding. 2/ Such a ceiling would be complementary to the above recommended approach to ceilings relating to medium-term debt.

In general, the precise approach to be adopted in the case of short-term debt should be flexible. In formulating an appropriate ceiling, the staff will need to pay particularly close attention to the institutional arrangements present in member countries, including the procedures for monitoring and controlling different categories of

---

1/ This procedure (in the case of liabilities of the Central Bank only) has been followed in several programs (recently, for example, the Dominican Republic, Honduras, Mexico, and Turkey).

2/ In cases to date where short-term debt ceilings have been used, they have related to the stock of disbursed debt.

short-term debt. In addition, where there are particularly complex or uncertain elements present (as, for instance, when a major debt refinancing operation affecting short-term obligations is anticipated), it may be appropriate to set debt ceilings for relatively short periods into the future and to provide for a mid-term program review once these uncertainties are resolved. 1/

(v) Exclusions from the coverage of debt ceilings

In about half of the programs reviewed, the coverage of the performance criterion excluded certain kinds of nonconcessional loans, both refinancing/restructuring loans as well as a wide variety of other types. The quite wide diversity of approaches employed to date raise the question of whether it is appropriate to adopt a more uniform treatment in this area.

Exclusions relating to refinancing/restructuring loans

One rationale for the exclusion of refinancing/restructuring loans from the coverage of external debt ceilings formulated on a contracting basis 2/ is that, by definition, they leave unaltered the stock of debt outstanding. However, the purpose underlying debt ceilings is a broader one, namely, to ensure that debt service payments associated with the size and structure of external debt are consistent with the medium-term

1/ The approaches taken to short-term debt in several recent programs are illustrative of this flexibility. For example, the program with Argentina contains two ceilings on the increase in outstanding public sector debt, the second of which is designed to limit the increase in maturities falling due within three years of the test dates; the debt coverage includes all short-term debt (including trade-related debt) with a maturity over 45 days. In the case of Brazil, the overall ceiling on total disbursed debt (public and private) included two categories of short-term debt (incorporating about 80 per cent of all documented short-term credits), namely, the net external position of commercial banks (which are largely privately owned) and the net use of credit lines by PETROBRAS, the oil importing entity. The definition covers all bank-related import financing (normally defined trade credits are excluded) and export preshipment credits. The Mexico program also provided for a global ceiling on net public sector borrowing including all bank-related import financing, and preshipment credits related to petroleum. The program with the Philippines contained the authorities' intention (which was not a performance criterion) regarding the change in net short-term debt outstanding (private and public) excluding two categories: open accounts and documents against acceptance. However, the authorities' implementation of the external borrowing policy--including the understanding on short-term debt--is subject to the program's mid-term review, which is a performance criterion.

2/ The problem of excluding refinancing/restructuring loans does not arise in the case of ceilings on disbursed debt.

debt servicing capabilities of the economy. From this perspective, certain kinds of refinancing loans may militate against the achievement of this objective. Thus consider, for example, a situation where it is viewed as appropriate that the stock of outstanding debt of the member should grow at no more than a certain targeted rate. This target can be achieved by a ceiling on newly contracted debt which takes into account the expected profile of amortization payments. However, if a refinancing loan is unexpectedly entered into which has the effect of reducing or eliminating some of the scheduled amortization payments, at the end of the program period the stock of outstanding debt will be higher than intended by the program. The effect of refinancing is to shift certain debt service obligations from the immediate future to a period further ahead, an outcome which may or may not be conducive to the adjustment strategy, depending upon the type of shift involved and the particular circumstances of the member.

These considerations point to the need for careful examination of the terms of any refinancing loans entered into in the light of their impact on the member's future debt service profile. In the case of debt reschedulings under the auspices of the Paris Club or multilateral commercial bank debt reschedulings, and which are often explicitly envisaged at the time the adjustment program is proposed to the Fund, there is ample scope for assessing whether the rescheduling terms agreed upon are likely to be consistent with the envisaged medium-term adjustment strategy. Moreover, in these situations, the Fund staff often have the opportunity to explain its assessment of the debt servicing outlook directly to the groups of creditors involved. However, where other more informal refinancing operations relating to individual lenders are concerned, there exists less assurance in advance that the outcome will be consistent with the adjustment strategy.

In view of the above, the staff regard it as advisable that normally only those restructuring loans explicitly identified as being associated with official or multilateral commercial bank debt reschedulings should be excluded from the coverage of the external debt ceiling. Other refinancing loans of an unspecified nature normally would be included. However, where the member intended to explore the possibility of entering into such refinancing arrangements during the program period, it would be explicitly understood that the debt ceiling set at the outset of the program could be reviewed by the Fund following the conclusion of the agreements in question. As an alternative, debt ceilings might only be set for part of the program period prior to the completion of the refinancing arrangements.

Exclusions other than refinancing/restructuring loans

Apart from restructuring/refinancing loans, the design of some programs was such that other excluded loans were integrated directly or indirectly elswehere in the program; as examples, certain types of external loans to the public sector were included in a ceiling on total borrowing by the public sector, or certain external liabilities of the

banking system were integrated as part of the net foreign assets test (see above). However, in other cases, the authorities explained that they were not in a position to indicate at the time the program was formulated the amount of the loan(s) that might be involved.

However, there is a danger that the widespread use of exclusions may, in some circumstances, unwittingly undermine the basic objective of the debt guideline, namely, to ensure that the quantum and quality of external commitments entered into are consistent with the economy's debt servicing capacity. It is therefore recommended that such exclusions (in particular, those that are not integrated elsewhere in the program), be avoided. Where exclusions are proposed, the staff would explicitly indicate why the contracting of such loans is not a relevant factor in the assessment of the adjustment process. Where there is considerable uncertainty regarding the timing and amount of a particular loan, the debt ceiling may be formulated to allow for an adjustment for the loans in question up to a specified amount, with the understanding that this amount could be subsequently reviewed once more information is available.

VI. Conclusions

The external debt servicing difficulties currently faced by many members have implications for Fund policies and activities in many areas and Directors may wish to provide guidance on a number of specific issues.

1. A first set of issues concerns the implementation of external debt surveillance.

As one aspect, it will be important to continue the close cooperation with the World Bank in questions related to external debt and the more detailed attention given to external debt matters in the most recent World Economic Outlook papers. Also, the Fund itself will undertake to improve the availability of debt information. The work now under way in the Bureau of Statistics, including the international banking statistics project and the utilization of external debt data available within the Fund and elsewhere, will lead to improvements in this area. In this regard, SM/83/48 discusses issues relating to collaboration with other international institutions, technical assistance to members, and publication of external debt statistics by the Fund. At the same time, members could be encouraged to avail themselves of the technical assistance in the external debt field offered by the Central Banking Department.

It is clear from recent experience that improved domestic economic policies can be of critical importance in preventing the emergence of debt servicing difficulties. Therefore, it is proposed that there be a major strengthening of the external debt surveillance content of the Article IV consultation process. First, efforts will continue to

improve the comprehensiveness of the reporting of recent external debt developments; in this regard, particular attention will be paid to movements in usable external short-term assets in relation to short-term liabilities. In addition, it is suggested that, for members with significant external borrowing operations, the staff report normally will include a report of the discussions with the members' authorities of the medium-term debt outlook and the policies they view as consistent with the maintenance of the debt service burden within appropriate bounds. Such discussions will be based on a "forward-looking" technical scenario analysis prepared in close cooperation with the authorities. Full weight will be given to the important elements of judgment involving the circumstances of each member, and special care will be taken to avoid undue reliance on statistical indicators alone.

Concerning cooperation with commercial lenders, the present policy of not releasing Article IV and use of resources documentation to commercial lenders continues to be appropriate. However, the Fund will be prepared to assist members in collecting information which they may wish to put at the disposal of the Institute of International Finance and to make available nonconfidential information to the Institute. Also, there remains considerable scope for enhancing the informal contacts between the Fund and national banking supervisory authorities.

2. A second set of issues arises from the relationship between the various forms of balance of payments assistance and the implementation of adjustment efforts in the context of Fund-supported programs.

As regards official multilateral debt renegotiations, most features are well established and should be continued. For members with structural debt problems, a number of creditors are currently discussing the role of debt relief in helping to re-establish the medium-term viability of the debtor's economy. In circumstances where the provision of official and commercial debt relief has not been sufficient to support the implementation of a viable adjustment program, the Fund has played an important role in donor meetings designed to provide additional exceptional assistance. In cases of low-income countries with structural debt problems and with satisfactory adjustment policies, the success of an individual debt rescheduling is likely to be strongly influenced by the availability of sufficient concessional aid assistance.

Concerning commercial bank debt rescheduling, where appropriate the Fund staff, with the support of the debtor country, will seek to facilitate discussions with the commercial bank groups involved. If requested to do so by the debtor country, the staff will explain to private lenders the implications of the adjustment efforts being carried out by the authorities, while pursuing a neutral role vis-a-vis different groups of creditors. In a relatively few circumstances of exceptional character where the difficulties encountered by major debtors have had broader implications for the orderly functioning of the international financial system, the Fund management has taken the initiative, in concert with major creditors, in ensuring that before Fund resources

could be committed, sufficient additional financial flows from both official and commercial sources were available to adequately support the adjustment efforts of the members concerned. In view of the exceptional nature of the initiatives, it would not be appropriate to attempt to formalize any general policy criteria concerning the precise role of the Fund in such situations. At this time, a case-by-case approach, in full consultation with all parties involved, is suggested as the best course of action. It is recognized that this is an especially sensitive area and difficult decisions will be required regarding the extent and nature of the Fund's involvement.

Finally, in this connection, it is inevitable that a considerable degree of uncertainty may often be present as regards the amount and timing of external financing to be made available during the period of an adjustment program supported by Fund resources. However, undue delay in the adoption and implementation of a program until these uncertainties were completely resolved could have significant adverse implications for the member concerned. Concerning Fund-supported adjustment programs with ex ante financing gaps, suggestions are advanced in Section V.1.b to best reconcile the interests of members and of the Fund. In the case of the rescheduling of arrears, it is suggested that where there are major uncertainties present, programs might focus on a phased reduction by means of net cash payments of those arrears that are not the subject of renegotiations.

3. A third set of issues relates to experience with the 1979 guideline on external borrowing.

Experience indicates that the guideline on the performance criteria with respect to foreign borrowing has been useful. As regards the form of the debt ceiling, however, it is suggested that normally the use of ceilings on disbursed rather than contracted debt will be more appropriate. So far as the coverage of the borrower is concerned, in the case of medium- and long-term debt, whether or not to include the external liabilities of the banking system in the ceiling would largely depend on the effectiveness of policy instruments available to the member; in many cases, it would be advisable to place a direct limitation on this form of borrowing. Regarding private debt directly contracted abroad, on balance it is felt that this type of borrowing need not be generally subject to the borrowing ceiling except in the particular circumstances outlined in paragraph 5 of the 1979 guideline.

As regards other aspects of the guideline, it is suggested that there is scope for supplementing, as follows, the points contained in the Chairman's Summing Up of the 1979 Board discussion on External Debt Management Policies (EBM/79/106 and 79/107, 7/6/79, and EBM/79/121, 7/23/79) (see Annex):

a. Staff papers, in describing adjustment programs submitted by members in connection with requests for upper credit tranche stand-by arrangements or extended arrangements, will contain an analysis of the

proposed external borrowing limitation in the light of the prospective medium-term debt servicing profile of the member. In addition to debt service payments relating to existing external debt, the assessment will normally also take account of projected debt service payments associated with new commitments that might be entered into by the member in the medium-term period following the expiration of the arrangement.

b. In order to ensure greater flexibility in adapting the debt limitation to the specific capital market conditions facing each member, the upper maturity limit for loans covered by the guideline would normally be 15 years. To the extent that loans from multilateral development institutions fall within the maturity range, appropriate allowance would continue to be made for these loans in formulating the ceiling (paragraph 7 of the guideline). Short-term debt of a maturity of less than one year will normally be included in the performance criteria relating to foreign borrowing. Flexibility will be exercised as regards the coverage of the ceiling on short-term debt, in light of the institutional and reporting procedures employed by members. However, it will generally be desirable to include nontrade-related borrowing by the public nonfinancial sector as well as the net short-term external liability position of the banking system, unless the latter is included in a net foreign asset test.

c. Normally, the coverage of the performance criteria will exclude only concessional loans, except in the case of ceilings on the contracting of debt where those restructuring/refinancing loans specifically associated with multilateral governmental or commercial bank reschedulings may also be excluded. In any exceptional instances where it is proposed to exclude other categories of loans, the staff paper will indicate the special reasons why such loans should be excluded.

Guidelines on Performance Criteria with Respect to Foreign Borrowing

The Executive Board Approves the Chairman's Summing Up on External Debt Management Policies As Set Forth [Below] Discussion No. 623-(79/140), August 3, 1979

The Chairman's Summing Up on External Debt Management Policies Executive Board Meetings 79/106 and 79/107 - July 6, 1979 and Executive Board Meeting 79/121 - July 23, 1979

In the context of a general discussion of the issues relating to external debt management policies, the Executive Board considered the following guideline on the performance criteria with respect to foreign borrowing:

> When the size and the rate of growth of external indebtedness is a relevant factor in the design of an adjustment program, a performance criterion relating to official and officially guaranteed foreign borrowing will be included in upper credit tranche arrangements. The criterion will include foreign loans with maturities of over one year, with the upper limit being determined by conditions in world capital markets; in present conditions, the upper limit will include loans with maturities in the range of 10 to 12 years. The criterion will usually be formulated in terms of loans contracted or authorized. However, in appropriate cases, it may be formulated in terms of net disbursements or net changes in the stock of external official and officially guaranteed debt. Normally, the performance criterion will also include a subceiling on foreign loans with maturities of over one year and up to five years. Flexibility will be exercised to ensure that the use of the performance criterion will not discourage capital flows of a concessional nature by excluding from the coverage of performance criteria loans defined as concessional under DAC criteria, where sufficient data are available.

Adoption of this guideline will be subject to the understanding that the staff will be guided also by the following points:

1. The above guideline will be applied with a reasonable degree of flexibility while safeguarding the principle of uniformity of treatment among members. The external debt guideline should be interpreted in the light of the general guidelines on conditionality (Decision No. 6056-(79/38), especially guideline No. 4, which states:

> In helping members to devise adjustment programs, the Fund will pay due regard to the domestic social and political objectives, the economic priorities, and

the circumstances of members, including the causes of their balance of payments problems.

Also, guideline No. 9 includes the following:

> The number and content of performance criteria may vary because of the diversity of problems and institutional arrangements of members. Performance criteria will be limited to those that are necessary to evaluate implementation of the program with a view to ensuring the achievement of its objectives.

Furthermore, guideline No. 8 states:

> The Managing Director will ensure adequate coordination in the application of policies relating to the use of the Fund's general resources with a view to maintaining the non-discriminatory treatment of members.

2. While uniformity of treatment indicates a need for a common upper maturity limit, this limit will be reviewed annually by the Executive Board at the time of its consideration of staff papers on conditions in international capital markets. In analyzing the amounts and terms of new borrowing that would be appropriate--in the member's circumstances--over the medium term, the staff will take into account prospective developments in the member's external payments situation and the profile of its external indebtedness.

3. In formulating external debt criteria, the staff will be mindful of the need to ensure consistency between external debt management policies and domestic financial policies. Where external debt per se is not a matter for concern, but adjustment programs have as a main objective to reduce excess demand pressures and restore overall balance to the public sector finances, the credit ceiling for the public sector would cover both domestic and foreign financing of the overall public sector deficit.

4. Normally, the performance criterion will relate to official and officially guaranteed foreign borrowing. The coverage will include official entities for which the government is financially responsible as well as private borrowing for which official guarantees have been extended and which, therefore, constitute a contingent liability of the government.

5. In cases where the member's external debt management policy covers private sector borrowing without official guarantee and there is an established regulatory machinery to control such borrowing, it will be proposed that the performance criterion on foreign borrowing should be adapted accordingly.

6. Normally, loans of less than one year maturity will be excluded from the borrowing limitations. In exceptional circumstances where nontrade-related loans of less than one year of maturity become a source of difficulty, such loans will be included in the limitations. The Managing Director will inform Executive Directors in an appropriate manner of the reasons for including such loans in the limitation.

7. The last sentence of the guideline provides for excluding from the coverage of performance criteria, those loans defined as concessional under DAC criteria. Available information on loans by multilateral development institutions indicates that all of the recent loans of the IBRD and the Inter-American Development Bank have been outside the 10 to 12 year limit and that most of the loans by the Asian and African regional development banks have also been outside the upper limit. In discussing with member countries the total amounts of permissible borrowing of less than 10 to 12 years maturity, the staff would take into account possible lending of less than this maturity range by multilateral development institutions. In some cases, member countries utilize credits associated with concessional loans. The staff will take into account these developments in discussing the appropriate amount of borrowing.

Illustrative Analysis of Medium-Term Debt Scenario

	Actual	Projected				
	1982	1983	1984	1985	1986	1987
Debt service payments						
a. Payments on existing debt 1/						
Interest 2/						
Amortization						
b. Payments on new borrowings 3/						
Interest						
Amortization						
c. Total (a + b)						
Interest						
Amortization						
d. Total debt service payments/ exports of goods and services						
Balance of payments						
Current account						
Exports of goods and services						
Imports of goods and services; of which:						
Interest payments						
Capital account (net)						
Of which: gross borrowings						
IMF (net)						
Gross reserves (months of imports)						
Other macroeconomic indicators						
Real growth rate (per cent change)						
GDP/GNP						
Domestic expenditure						
Ratios to GDP/GNP (per cent)						
Investment						
Domestic/national savings						

1/ If relevant, interest charges and repurchases relating to IMF purchases would be shown separately.

2/ Including interest on short-term debt.

3/ Terms assumed for interest rates, grace, and repayment periods.