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Concluding Remarks by the Chairman
Issues in Managing the Debt Situation
Executive Board Meeting 89/36, March 17, 1989

Executive Directors welcomed the initiative taken by the Secretary of the Treasury of the United States, which aimed at strengthening the debt strategy by placing greater emphasis on the content and structure of financing packages, including debt reduction--a movement in the direction that Directors had endorsed at their debt discussion in August. They also welcomed the staff paper on managing the debt situation, which they found provided a most concise and thoughtful basis for our discussion today.

All Directors laid particular stress on a basic principle underlying the debt strategy--that the sustained implementation of policy reforms in debtor countries is key. To the extent that the role of debt reduction in the menu of financing options increases, the adjustment framework becomes still more important. Appropriate financing must support growth and adjustment, but it cannot be the engine to achieve these objectives.

A number of Directors pointed to the continuing need for new finance. This was true not only for heavily indebted countries but also for those countries that had maintained market access, and for whom the Fund could continue to provide policy advice, including in the formulation of medium-term financing plans, and support, as appropriate, through the use of Fund resources. The Fund's catalytic functions applied to these countries as well as to those with debt-servicing difficulties. This point was particularly emphasized by several speakers--and it is indeed imperative that we avoid moral hazard and maintain an evenhanded approach. In the same vein, it was stressed that debt reduction should be seen as encouragement for countries to manage their economies well and not as a reward for managing them badly. Speakers observed, in particular, that there was a two-way relationship between debt reduction operations and the return of flight capital, namely, the greater the capital repatriation, the greater the scope for debt reduction operations; similarly, the greater the contribution of debt reduction operations to lowering the debt overhang, the easier the repatriation of capital. Together, debt reduction operations and the repatriation of flight capital could help foster a virtuous circle, given high-quality macroeconomic policies in the debtor country.

With regard to low-income countries, Directors welcomed the implementation of proposals to provide debt relief on bilateral debt as well as the provision of concessional resources that had resulted from initiatives in the international financial institutions. Some Directors pointed out that particularly pressing problems remain, however, for those countries which are not benefiting from access to exceptional official debt relief yet cannot afford to finance themselves on market terms.

With respect to middle-income countries with debt-servicing difficulties, Directors noted that for domestic adjustment to have the desired effect on domestic and foreign confidence and on growth, it must be backed

by financing that promises to shorten the path to viability. In this context, Directors welcomed the growing acceptance of the need for debt reduction. But the shift in emphasis toward debt reduction must not be an excuse for banks to delay support. As cases with strong adjustment programs supported by the Fund come forward, prompt action, based on direct negotiations between debtor and creditor, is urgent.

The Fund could help in assessing the need for debt reduction operations on the basis of medium-term financing scenarios; indeed, a number of Directors felt that Fund support should be conditioned upon an appropriate level and structure of external liabilities to secure medium-term viability. It was emphasized, however, that debt reduction operations would have to be voluntary and negotiated directly between creditors and debtors. The Fund could also catalyze additional resources, including for debt reduction operations where needed. Directors looked to a staff note setting out appropriate criteria for determining the need and scope for such operations.

Broader debt reduction operations that balance the needs of creditors and debtors are already under consideration in the financial markets. Many Executive Directors stressed the need for creditor governments to review their legal, tax, accounting, and regulatory frameworks so as to make, where appropriate, positive changes to support market developments. Most Directors looked to the staff for continued fact-finding in this area. Banks must also move to allow debt reduction through prompt provision of the necessary waivers to existing contract provisions.

Executive Directors stressed that a further essential action was to mobilize national resources, through the repatriation of flight capital, to meet countries' financing needs. Some Directors observed that the timing and magnitude of such return flows would be uncertain and that they would be much influenced by the strength and determination of adjustment policies. In that regard, it was pointed out that too gradualist a medium-term policy framework was certainly not the best approach. It would also be important for debtor countries to signal their willingness to play their part in the cooperative strategy by providing a hospitable environment for direct foreign investment.

Directors agreed that if greater debt reduction alongside new financing was to succeed in returning countries to normal market access, there must be safeguards to the effect that contracts will be maintained and new and rescheduled debt will be fully serviced. The strongest safeguard would be the pursuit by countries of a strong medium-term adjustment program, supported by the Fund and the World Bank. Thus, phasing debt reduction in parallel with the implementation of internationally endorsed economic policies would be essential.

* As regards the Fund's own financial involvement, there was broad support for direct or indirect Fund involvement in debt or debt-service reduction, with a few Directors welcoming the U.S. suggestion that a portion of Fund and World Bank policy-based lending could be set aside to

* Corrected lines 1 and 2

support debt or debt-service reduction operations. However, most Executive Directors pointed to the need to assure that sufficient resources would be available for general balance of payments support of stabilization efforts, which was and remained the key financing role of the Fund.
* A number of Directors advised great caution, and a few questioned the appropriateness of direct support by the Fund, in financing debt reduction operations. Other Directors saw scope for including reserve needs arising from debt or debt-service reduction operations in the assessment of appropriate access to Fund resources. These resources could be supplemented by those of the debtor country and other interested parties. In the next few weeks we should return to these questions and consider further whether and in what circumstances Fund resources, or resources held in trust by the Fund, might be used to secure interest on debt exchanges or to finance or reconstitute a country's reserves after it finances debt or debt-service reduction operations.

Directors noted that under its policy on financing assurances, the Fund needed to pay due regard to the quality as well as the quantity of financing packages and to strengthen its ability to support strong adjustment programs in a timely manner. Directors looked forward to a staff paper on financing assurances for discussion in the next few weeks. They expressed a willingness to review the concept of the so-called critical mass and existing practices with respect to the assembling of financing packages. Several speakers stressed the difficulties that arose for Fund financing when considerable financing gaps remained and the need to consider how practices might be adapted to allow the Fund to react quickly to support and monitor appropriate programs where these were being implemented. In the same context, careful attention would need to continue to be paid to the Fund's preferred creditor status. While it was important for the Fund to be in a position to support adjustment efforts quickly at the outset, the Fund retained a strong interest in all cases to see rapid progress in the cooperative resolution of countries' payments problems. In fostering prompt but negotiated progress, the Fund's role would be of central importance.

** Some Directors questioned whether members' access to Fund's resources would not be seriously curtailed when the policy on enlarged access was phased out unless there was a substantial increase in quotas, noting that a reduction in the amount of access could importantly constrain members in approaching the Fund for timely balance of payments assistance. Others did not share this view. A suggestion was also made that SDR allocations could play a positive and helpful role in support of debt and debt-service reduction operations.

Directors also looked to the staff for further work assessing the proposals that had emerged from the discussion and from the approach suggested by the U.S. Secretary of the Treasury. It is clear that the debt strategy will remain high on the agenda of the Board's work program after the Interim Committee's April meeting, and these new avenues will have to be explored further, perhaps in a seminar format.

* Corrected line
** Corrected lines 1-8