May 24, 1989 - 89/89

Summing Up by the Chairman
Fund Involvement in the Debt Strategy
Executive Board Meeting 89/61
May 23, 1989

This has been an important discussion, following the guidance of the last meeting of the Interim Committee, with a view to laying the basis for broad guidelines for the Fund's role in the evolving debt strategy and, in particular, for Fund support for debt and debt service reduction. It is clearly the wish of this Board that the Fund discharge in full its central responsibilities in the debt strategy, but without interference in negotiations between debtors and creditors. We recognize that we are at an experimental phase in the debt strategy and will keep all aspects of developments under review as I will describe more specifically below.

In considering Fund support for debt and debt service reduction operations in conjunction with appropriate flows of new money, Directors emphasized the central importance of sustained implementation of policy reforms in debtor countries. They stressed that all parties in the debt strategy should continue to play their respective roles and, in particular, that official creditors should not substitute for private creditors. Fund support for debt reduction operations would be linked to medium-term adjustment programs with a strong element of structural reform, adopted in the context of stand-by or extended arrangements. Particular emphasis would be given to measures that would improve the climate for saving and investment in borrowing countries, and help reverse capital flight and attract private capital inflows and direct investment. Adherence to MIGA was seen by a number of Executive Directors as a useful step in the investment area. Utilization of debt equity swaps, where compatible with a member's fiscal and monetary policy framework, has also been seen by a number of Directors as a particularly effective means of attracting a return of flight capital.

Executive Directors agreed that requests for Fund support of debt and debt service reduction operations would be considered on a case-by-case basis. Particular reference would be made to three elements--the strength of economic policies; the scope for voluntary, market-based debt reduction operations that would help the country regain access to credit markets and attain external viability with growth; and an assessment as appropriate that such operations represent an efficient use of scarce resources.

Executive Directors strongly emphasized the importance of ensuring continued support for countries that have succeeded in maintaining market access and would not engage in officially supported debt reduction. The creditor community, including the Fund, will need to watch the situation of these countries carefully to ensure that they are not harmed by changing circumstances and that appropriate assistance continues to be forthcoming. This is an important area to which Directors have agreed to return before the Annual Meetings.

Directors stressed that it will be important to keep the Fund's liquidity position under close review. It is considered that the provisions for Fund support of debt and debt service reduction operations that have been discussed could be accommodated without an undue deterioration in the Fund's liquidity position in the near term. However, the implications of the Fund's support of debt and debt service reduction operations will need to be taken into account by Executive Directors in considering the factors bearing on the need for an increase in quotas under the Ninth General Review of Quotas. In particular, Fund support for debt reduction operations must not be allowed to reduce the Fund's ability to support members that are not engaging in such operations.

As regards the particular modalities of Fund support for debt and debt service reduction, Executive Directors agreed that in appropriate cases part of a member's access under an extended or stand-by arrangement could be set aside to finance such operations. The exact size of the set-aside would be determined on a case-by-case basis, but would involve a figure of around 25 percent of access determined on the basis of existing access policy. A number of Directors noted the importance of principal reduction in helping to ease the member's debt burden, and it was agreed that set-aside amounts should be used to support operations involving principal reduction, such as debt buy-backs or exchanges.

The availability of the set-aside amounts would generally be phased in line with program performance. Where warranted, some front-loading could be considered or purchases could be phased in accordance with the specific financing needs of the member's debt reduction program.

Directors agreed that there could be an initial release of Fund resources in support of debt reduction if the program was on track, if the Board was satisfied with the authorities' description of the debt reduction program, and on the understanding that debt reduction operations would be market based or at market-related prices, involving substantial discounts. Initial purchases under the set-aside could be made available from the outset of an arrangement if these conditions were met. Otherwise, purchase rights would accumulate and be made available upon completion of a review by the Board of the debt reduction plan.

Executive Directors also agreed that in appropriate cases the Fund would be prepared to approve requests for additional resources of up to 40 percent of a member's quota, where such support would be decisive in facilitating further cost-effective operations and catalyzing other resources, consistent with significant further progress toward external viability. The additional resources from the Fund are to be used for interest support in connection with debt reduction or debt service reduction operations. It was understood that the amount of additional resources to be provided would be determined on a case-by-case basis, in light in particular of the magnitude of the member's balance of payments need and the strength of its adjustment program as well as its own efforts to contribute resources, as feasible, in support of the operations. The

limit for additional access is not to be regarded as a target. In considering a request for additional resources, the Executive Board would be presented with detailed information, as available, on the operations to be supported; the timing of actual disbursements to the member would need to be determined in light of the specific operations. Access pursuant to such requests would be additional to that determined under the existing guidelines for enlarged access, it being understood that the present policies on enlarged access will continue to apply, including the exceptional circumstances clause.

In the event a commitment by the Fund to provide additional access for the purposes specified were not used, the commitment would expire at the end of the arrangement period. The member would be expected to make early repurchases of amounts drawn under a commitment of additional access, to the extent that the amounts were not used within an appropriate period for the purposes described in the member's request.

Directors stressed the importance of ensuring that resources made available for debt and debt service reduction operations were used effectively. Directors agreed that there would be a need for periodic reviews to consider how debt reduction operations compare to the Board's initial expectations; if appropriate, the Board could in such reviews reconsider the modalities of the Fund's support for the member's debt reduction plan.

Executive Directors noted that the World Bank would likely be involved, along with the Fund, in supporting debt reduction operations when these are important elements in a country's financial and development strategy. In these cases, Directors stressed that it was important that the two institutions work together closely in securing effective debt reduction. This does not mean each institution must provide equal amounts in each case, as the amounts will need to be taken on a case-by-case basis. The managements of the two institutions are working closely on these matters and Executive Directors will be kept informed of the progress made in support of these operations on a continuing basis.

In discussing financing assurances, Executive Directors reaffirmed the basic objectives of the Fund's policy--ensuring that the program is fully financed; that the financing is consistent with a return to viability and with the ability of the member to repay the Fund; that there is fair burden sharing; and that the program, if appropriately implemented and supported, would contribute to the maintenance or reestablishment of orderly relations between the member and its creditors.

Nevertheless, Directors agreed that there is a need for cautious adaptation of the Fund's policy in light of the changed financial environment and the possibility that in some cases significant time may be needed for banks and the member to agree on an appropriate financing package. In such circumstances, the Fund would on a case-by-case basis approve an arrangement outright before the conclusion of such negotiations, provided that prompt Fund support is judged essential for program implementation, that negotiations between the member and its bank creditors have begun,

and that it can be expected that a financing package consistent with external viability will be agreed within a reasonable period of time. Management would continue to consult with Executive Directors at an early stage in such cases. Progress in the negotiations with bank creditors would be closely monitored, and any unforeseen development brought to the Board's attention. When circumstances warrant, the practice of seeking a critical mass, as well as the possibility of approving an arrangement in principle, would remain valid.

Directors stressed that in promoting orderly financial relations, every effort must be made to avoid arrears, which could not be condoned or anticipated by the Fund in the design of programs. Nevertheless, an accumulation of arrears to banks may have to be tolerated where negotiations continue and the country's financing situation does not allow them to be avoided. Directors emphasized that appropriate safeguards would need to be incorporated into the monitoring procedures of the Fund arrangement. The Fund's policy of nontoleration of arrears to official creditors remains unchanged. The debtor member would be expected to continue to treat creditors on a nondiscriminatory basis. Directors agreed that while negotiations with bank creditors were continuing, the situation would need to be monitored closely. Performance criteria would be quarterly. A review of progress in the negotiations would be scheduled at an appropriate time and, normally, before the second disbursement.

These essential points provide a clear, and clearly limited, basis for the Fund to proceed with initial country operations. We are at an early stage, but we must move forthrightly to begin implementation. It is understood that the Fund's policy, and the precise modalities for application of the policy, will evolve under the Board's guidance as individual cases come forward, or are reviewed, and in light of continuing staff studies. We will take stock of progress in connection with our discussion of the management of the debt situation before the Annual Meetings, and we will plan to review the overall experience in a year or earlier if the situation requires.