International Bank for Reconstruction and Development

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FROM: Vice President and Secretary

April 27, 1990

EXECUTIVE DIRECTORS' MEETING - APRIL 10, 1990

Review of Progress Under the Program to Support Debt and Debt Service Reduction

Chairman's Summing-Up

On April 20, 1990 a revised Chairman's Summing-Up of the discussion of the President's Memorandum entitled "Review of Progress Under the Program to Support Debt and Debt Service Reduction" (R90-48) was circulated with the request that further comments be sent to the Vice President and Secretary or the Deputy Secretary by the close of business on Wednesday, April 25, 1990 (SecM90-471/2). A number of Directors submitted their comments.

The Chairman has reviewed the comments received and the record of the meeting. Attached is the final Summing-Up of the Chairman, which is being transmitted to the Development Committee as agreed at the Board Meeting.

Distribution:

Executive Directors and Alternates
President
Senior Vice Presidents
Senior Management Council

Board Discussion on
Review of Progress Under the Program to
Support Debt and Debt Service Reduction
(Board Discussion of April 10, 1990)

Chairman's Summing Up

1. Today's discussion has been the first review of the program to support debt and debt service reduction and has provided a timely opportunity to reflect on what has happened thus far and what needs to be done to keep the program moving forward in an appropriate fashion: The discussion did not cover some other, broader, policy issues in the debt strategy, such as the need for structural adjustment in the debtor countries, for open and growing markets for their exports, and for sustained financial support from official creditors. Directors expressed strong support for the program, and today's discussion has provided further guidance as to how the program should be implemented in the future. Directors are generally satisfied with the guidelines and agree that the basic policy framework for the program should remain unchanged. Most Directors also support a flexible approach to implementing the program.

2. Directors generally agreed that there has been substantial progress in the debt strategy as a result of the new initiative. Reducing debt and debt service obligations within the context of medium-term adjustment programs is clearly the right approach, and important results have been achieved in the agreements completed so far. Nonetheless, Directors noted that the process has been more difficult than expected and that there were important issues that needed to be addressed on an onging basis. Directors emphasized the importance of assuring that debt and debt service reduction programs supported by the Bank be part of a viable financing plan over the medium term and that these programs be appropriate to the needs and circumstances of the particular country. These are central issues to be addressed in the debt and debt service reduction agreements, and Directors stressed that Bank staff should make every effort to inform both commercial banks and debtors that the World Bank will place a great deal of weight on these points in evaluating whether and to what extent the Bank will support the proposed agreements. Some Directors noted that the agreements supported so far contained adequate financing for the adjustment programs and expressed concern that applying too stringent conditions for fulfilling financing requirements could result in too rigid an approach and be potentially counterproductive to achieving successful agreements.

3. Directors stressed the need to ensure also that adequate allowance is made for adverse contingencies and downside risks. Official creditors should not be counted on to fill future gaps resulting from adverse events, and debt agreements would need to retain flexibility in future debt management. Directors agreed that commercial banks should be encouraged to include contingency arrangements, particularly to provide symmetry where there are recapture clauses. In the absence of specific provisions for contingencies, the World Bank would look for other elements to provide against downside risks, including provision for higher reserves.

4. A number of Directors noted the dangers in spreading official enhancements too thinly, thereby creating a structure where the bulk of commercial debt is relatively inflexible. Use of buybacks could help avoid this problem by focusing on a small portion of the debt and leaving a larger future new money base. However, it was also pointed out that debt conversions provided important advantages as part of an overall package of debt and debt service reduction. This reaffirms the need for a case-by-case approach, a wide range of options in menus, and flexibility in the Bank's support.

5. Directors agreed that when deciding if an agreement meets the Bank's criteria for funding, the focus should be on whether there are material benefits contributing to the country's development prospects, not specifically whether the agreement was "comprehensive" or not. Transactions dealing with only a part of the debt would be acceptable, provided they confer material benefits to the country, constitute part of an overall adjustment program and financing plan supported by the Bank, and are deemed by the Bank to facilitate investment for productive purposes in the country.

6. Directors noted that although a phased approach to providing Bank resources for debt and debt service reduction has been considered to be the norm in the guidelines, frontloading has been a feature of several of the agreements reached thus far. It was recognized that some flexibility would continue to be required in this area to achieve adequate and appropriate financing arrangements. Frontloading would be justified where there is a satisfactory track record of adjustment, where it helps mobilize an appropriate financing package, and where such a comprehensive package will have a major impact on changing investor expectations.

7. Directors noted the complications in negotiations caused by the lack of fungibility between set asides and additional funds but agreed that the basic framework of two different pools of funds was useful and should be maintained. A majority of Directors agreed that some flexibility should be allowed in the use of set asides and additional funds on a case by case basis. Some Directors felt that the lack of fungibility has not constrained the agreements being reached so far and has encouraged the expansion of options in financing packages. My sense is that there is a consensus to leave this guideline unchanged. However, most Directors would be prepared to consider some flexibility in the use of enhancement funds where this can be justified in a particular exceptional case.

8. With respect to the nature of the Bank's role in the negotiations, Directors agreed that it was important to maintain the carefully balanced approach as set forth in the guidelines. It was recognized that the Bank had been involved in providing advice and information to the parties, and that it should continue to do so. However, given the issues at stake, most Directors were in favor of a stronger role than had been the case thus far and supported management's proposal to take appropriate steps to ensure at the outset of the negotiations that the parties clearly understand the financing requirements of the country, the terms and amount of official support that could be provided, and the need for a robust and viable medium term financing package. It was agreed that the Bank should stand ready to provide advice during the course of negotiations on the financial parameters that would justify World Bank support, including provisions for

contingencies. The Bank should also make clear that its financial support for debt and debt service reduction should not be taken for granted and that its concerns about the adequacy and appropriateness of financing over the medium term will need to be satisfied. Directors reiterated that the Bank's guidance to negotiations be consistent with a voluntary, market-based approach and that the Bank should avoid prescribing the form or the terms for debt and debt service reduction. Directors also stressed that management should continue to keep the Board informed on all on-going negotiations.

9. A number of Directors drew attention to the need to achieve a fair burden sharing between commercial banks and the official sector in debt and debt service reduction. It was noted that the official sector was already doing a great deal and expected the commercial banks to carry a fair share. It was understood that the share of the official sector would rise following debt reduction operations; however, equitable contributions to financing requirements would continue to be an important consideration, as would sharing the burden of future risk and responsibility to meet unforeseen financial needs of the debtor.

10. It was noted that delays in reaching agreements could lead to a build-up of arrears, which might need to be accepted as a "necessary evil." Where debtors were continuing to implement satisfactory adjustment programs and were prepared to make reasonable efforts to meet debt service obligations to their creditors, continued Bank support of the countries would be acceptable along the lines of current policy. However, it was recognized that debt workout programs supported by the Bank must involve a plan for eliminating arrears in a timely fashion and that close collaboration with the IMF on this issue is required.

11. Directors generally supported the Bank's present restrictive practice of not providing waivers of its negative pledge requirement, other than for the assets providing collateral in Bank supported programs. Some Directors favored a less restrictive application of the waiver policy because the more restrictive policy could preclude efficient, follow-on debt and debt service reduction operations. In response to requests from most Directors, management agreed to provide a paper addressing the policy issue of granting waivers to the Bank's negative pledge clause. A discussion of this will be scheduled appropriately. In addition, a Board seminar will be arranged on methodological issues of evaluating debt agreements, including issues relating to contingency financing.

12. Directors agreed on the importance of continuing regular evaluations of the program and its modalities, and they suggested another review in about a year unless new issues surface and made an earlier review appropriate. Any such development will, of course, be promptly brought to Directors' attention.