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SUBJECT FILES

DEBT - Brady proposals / debt
reduction general (3)
1989-91


Archives



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Debt - Brady Proposals / Debt Reduction - General - Correspondence 03

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The World Bank/IFC/MIGA
O F F I C E M E M O R A N D U M

DATE: 30-Apr-1990 09:29am

TO: Moeen A. Qureshi

(MOEEN QURESHI)

FROM: John D. Shilling, CFSFA

(JOHN D. SHILLING)

EXT.: 72773

SUBJECT: Preliminary Negotiating Notes

I reviewed the final versions of the notes over the weekend and most seem in good shape. An annex is coming up this morning on Cote d'Ivoire with more details on the proposed approach, and Brazil should be ready today.

The note on Morocco, which was not shown to us, does raise a couple of problems. In the region's memo to Mr. Conable on April 12, they implied that the Bank would not support the Part I buyback, but would be ready to support a Part II DDSR operation. I had assumed they were staying with the position. Their new note proposes to stand ready to support Part I buybacks. I would have two concerns with this: First, from the point of view of the Bank, it would be difficult to justify support of such an operation. The commercial banks expect those buybacks to be achieved by shopping in the market with available reserves. For the Bank to support such an operation, there would probably have to be an agreed formal offer, pricing, etc. that I doubt the banks would be interested in negotiating. The Bank would not be able to fund a "war chest" for the Moroccans to negotiate a series of individual deals. Second, from the point of view of Morocco, there is no point in formally designating Bank disbursements as set asides at this time. There is no increase in the amount of money available, and there are more strings attached. In particular, if a formal buyback is presented to the Board, the market price is likely to increase. It would be better for the government to just use available funds now and then use both the set asides and incremental funds to have greater impact on a Part II deal.

Do you want to have a quick meeting on the set of notes to get your comments before putting them into final form.

CC: Ngozi Okonjo-Iweala

(NGOZI OKONJO-IWEALA)

CC: David R. Bock

(DAVID BOCK)

Hold -
replaced by
Matrix

OFFICE MEMORANDUM

900430026
a.H. Bock

DATE: April 30, 1990

TO: Mr. Moeen A. Qureshi

FROM: S. Shahid Husain

EXTENSION: 39001/02

SUBJECT: BRAZIL - Forthcoming External Debt Negotiations between Brazil
and its Commercial Creditors

1. On March 15, 1990, the new Brazilian government announced a comprehensive stabilization plan. By April 15, 1990, the core of the plan, which included substantial monetary and fiscal measures was approved by Congress. The program remains to be implemented effectively. The IMF is expected to visit Brazil in the second half of May to begin discussions with the Brazilian government on a new Stand-by Arrangement. The Brazilian government is not expected to begin substantial negotiations with the commercial banks until a successful agreement with the IMF is reached. Furthermore, the Brazilian debt strategy remains unclear. The government has just appointed its Chief debt negotiator, Mr. Jorio Dauster, and there have been press reports that Brazil may limit its total interest payments to \$5 billion a year, about 50% of the contractual amount. The government, at the moment, is still formulating its debt strategy. Consequently, these are early days and the information and figures provided in this note must be viewed as being very preliminary at this stage.

2. At the end of June 1989, Brazil centralized the management of its international reserves at the Central Bank. The government's rationale was that the measure was needed to preserve the stability of the domestic economy and to avoid a balance of payments crisis. This action led to the partial suspension of interest payments to commercial creditors in August 1989. As of end April 1990, arrears on most of Brazil's medium and long term external debt to commercial banks amount to approximately \$5.0 billion. Brazil has been servicing its short-term external liabilities and new money bonds all along.

3. When Brazil resumes negotiations with its foreign commercial creditors, possibly in June 1990 after negotiations with the IMF, the following three issues will be critical: the settlement of arrears; Brazil's eligibility for a reduction in its external debt, and/or a reduction in its external debt service under a "Brady Plan" type agreement with official support from the Bank and the IMF; and the merits of the external debt transformation package proposed by Brazil which would reflect its new external debt strategy. It is, however, worth mentioning that comparisons of Brazil's external debt burden with other highly indebted countries, in terms of GDP and total exports, indicate that Brazil's external debt is not overwhelming. Moreover, Brazil's government faces less of an external transfer problem than an internal transfer problem of raising domestically sufficient resources to service its debt. To ensure that Brazil has adequate financing during the implementation of its recently announced stabilization measures and structural reforms, external support in the form of debt reduction and new flows in FY91-93 will be critical.

4. Preliminary analysis indicates that an average annual growth of 4.8% over the next five years would require an average annual non-interest current account surplus of almost 2% of GDP. The projected cumulative current account deficit for the period 1990-94 is about \$9.9 billion, or about 0.5% of GDP per year on average. After considering foreign direct investment flows and funding from bilateral and multilateral institutions, the cumulative 1990-94 net financing gap is projected at approximately \$21 billion, or \$4.2 billion per year on average. These projections do not include any reduction in debt or debt service.

5. Although several of Brazil's major commercial creditors have already expressed their intent to accept some degree of debt and or debt service reduction, it is still premature to define the structure of the financing package. Nevertheless, the following debt transformation instruments could be included in any future agreement: debt exchanges into temporary or permanent relief instruments, debt for public equity, buy-backs, and new money.

6. Preliminary analysis suggests that, given the structure of Brazilian debt, the opportunity cost in the use of those resources at present and domestic macroeconomic considerations, from Brazil's point of view, the debt agreement should contain relatively more debt exchanges and debt for public equity, both with some type of contingent financing attached, and relatively less buy-backs. Substantial amounts of new money are not likely to be forthcoming. Given the Bank's already high exposure in Brazil, clearly from the Bank's point of view, transforming major parts of the debt into inflexible instruments should be avoided. Implementation of any financing package for Brazil that includes debt and/or debt service reduction will depend on the availability of the necessary credit enhancement from the Bank, IMF and other sources. Therefore, should Brazil reach a financing agreement with its commercial creditors in the near future, consideration will have to be given to the specific role that the Bank can play in providing part of the necessary credit enhancement. Consistent with the guidelines approved by the Board, a total of about \$800 million could be set aside from the Bank's total expected lending to Brazil in the three-year period FY91-93, and an additional amount of up to \$1.2 billion ^{1/} could be made available to support the reduction of Brazil's public external debt with commercial banks. The IMF guidelines indicate that, based on an estimated 18-month Stand-by Arrangement about \$375 million could be made available in set asides and up to about \$770 million in additional funds.

cc: Messrs./Mme.: Choksi, Michaely (LA1DR), Papageorgiou, Vatnick
(LA1CO), Shilling (CFSFA)

^{1/} These figures are based on the latest high case scenario presented in the Brazil Business Plan (October 1989). In the event the Bank does move into a high case lending mode, this scenario will be updated to take into account the latest economic developments. These figures should, therefore, be treated as being tentative at this stage.

FORM NO. 75
(6-83)

THE WORLD BANK/IFC

900430009
1.

ROUTING SLIP		DATE: 4/30/90	
NAME		ROOM NO.	
Mr. Qureshi			
APPROPRIATE DISPOSITION		NOTE AND RETURN	
APPROVAL		NOTE AND SEND ON	
CLEARANCE		PER OUR CONVERSATION	
COMMENT		PER YOUR REQUEST	
FOR ACTION		PREPARE REPLY	
INFORMATION		RECOMMENDATION	
INITIAL		SIGNATURE	
NOTE AND FILE		URGENT	
REMARKS: This briefing note on Cote d'Ivoire is useful on debt restructuring.			
FROM: Michel Bouchet		ROOM NO.: D3101	EXTENSION: 80007

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General Background on Cote d'Ivoire's Upcoming Debt Restructuring Negotiations with Commercial Bank Creditors

Overview of Macroeconomic Framework

1. Cote d'Ivoire currently faces two major economic challenges. First, overvaluation of the real exchange rate, excessive government interference in markets and the inappropriate regulatory environment result in substantial market distortions. Second, fiscal deficit has reached some 16 percent of GDP in 1989. Given the fixed parity of the CFA, RCI's authorities are firmly committed to achieving the needed real depreciation through internal adjustment leading to decreases in the internal prices of non-tradeables. These internal adjustment measures will also improve the fiscal situation. As an indispensable complement to absorption reduction measures, the Government is preparing a comprehensive program of structural reforms aimed at increasing wage and price flexibility, reducing distortions, improving the efficiency of the financial system, and enhancing competitiveness to be implemented over the course of 1990 and 1991. The Government hopes that the combination of deflationary policies and structural reforms will lead to a fall in nominal prices and wages and a rise in productivity. Cote d'Ivoire's economic difficulties are compounded by the very high external debt burden (para 3). The crushing debt burden is limiting available resources for investments and key recurrent expenditures in the social and infrastructure areas and is reducing the confidence of both domestic and foreign investors in the Ivorian economy.

2. In agreement with the IMF and the World Bank, the Government has begun the implementation of an economic program addressing these key macroeconomic issues in the context of an IMF Stand-by approved in November 1989, and two sectoral adjustment loans regarding agriculture and energy approved in October 1989 and January 1990, respectively. The most important measures adopted so far have been a 50 percent reduction in cocoa and coffee producer prices and freezing wage payments at their 1988 nominal level and other expenditure containment measures in 1989. However, in light of significant revenue shortfalls during 1989, the Government is preparing with the assistance of IMF and World Bank staff an enhanced policy package to improve budgetary management and reduce the budgetary deficit to some 11.5 percent of GDP in 1990.

Cote d'Ivoire's Debt Overhang

3. Cote d'Ivoire belongs to the category of highly-indebted countries according to the IBRD classification. Total debt outstanding is estimated at US\$15 billion at end-1989. Commercial bank debt amounts to US\$ 3.1 billion, including about US\$ 600 million of interest arrears. Cote d'Ivoire, indeed, has suspended service payments on M/LT debt since April 1987. External debt (including IMF) stands at about 100% of GDP. (Annex 1).

4. Cote d'Ivoire's economic situation during 1989 has deteriorated even more sharply than anticipated in the original adjustment program, resulting in a failure to meet key targets of the November 1989 IMF's stand-by agreement. As a result of policy slippages and worsening external environment (including delays in the availability of external financing), exceptional financing requirements have increased substantially. The

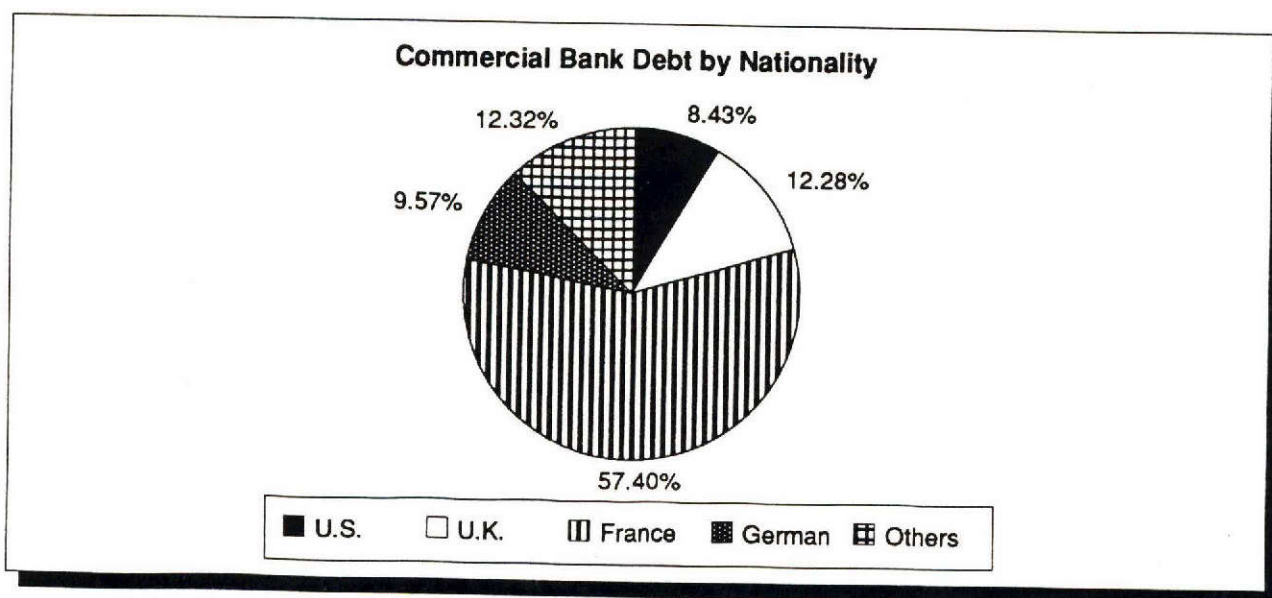
Ivoirian authorities and the donor community face the difficulty that the program appears currently underfunded and will require both drastic additional adjustment measures and larger financial support.

5. The Ivoirian authorities took the initiative to meet the London Club steering committee in the last weeks of 1989. The Minister of Finance accepted the principle to resume partial interest payments of the order of 20% of contractual obligations. Interest payments would be kept in a special account while a comprehensive debt restructuring is being negotiated.

6. Discussions have taken place regarding a phased debt reduction operations. The Bank and the Fund are providing technical assistance in close consultation with each other. During the joint IMF/Bank mission which just returned from Abidjan two weeks ago, the Government decided to rationalize and centralize economic decision-making in a core group of RCI's officials under the authority of Mr. Ouattara. This positive institutional development will clearly facilitate the upcoming negotiations with the London Club.

Phased Debt & Debt Service Reduction Scenario

7. The rationale for a phased in debt workout is threefold: (i) given RCI's adjustment track record official creditors would prefer tranching the disbursements of enhancement funds; (ii) a large debt reduction compatible with RCI's very limited debt servicing capacity would require extraordinary frontloading of official enhancements; (iii) commercial banks would prefer a graduated debt reduction scheme for accounting and regulatory reasons (especially French banks which account for almost 60% of RCI's debt).



8. A tentative menu of debt reduction instruments has been discussed with RCI's authorities. The menu would be applied over a three year period and broadly reflect the banks' constraints and motivations that are driven by long-term business interests and regulatory regimes. The terms and conditions of the instruments would be such as being equal to the current secondary market price (about 8 cents), as well as having equal present

value over the three-year period (Annex 2). Given the national distribution of commercial bank exposure, the most likely debt restructuring scenario appears as follows:

- downpayment of 8% of past due interest and the remaining being converted into long-term warrants. The warrants would be gradually amortized after a grace period depending on the coffee and cocoa prices.

- 1/3 of the stock of principal payments would be repurchased over three years at an average price of 8 cents.

- 50% of bank claims would be converted into par bonds with a reduced interest rate of 4.25%, 5.00% and 5.50% for each of the three years respectively. A one year rolling interest guarantee would be attached to the bonds.

- the remaining bank claims would be converted into discount bonds at around 50% with a market interest rate. A one year rolling interest guarantee would be maintained into an escrow account.

9. The total official funding requirements for such a scenario would be of the order of \$230 million over three years with equal shares coming from the Bank, the Fund, and bilateral donors. At the end of the exercise, RCI would benefit from a total debt relief equal to US\$ 1.3 billion. This calculated relief does not take into account potential debt reduction in relation with conversions of bank claims in the context of the domestic banking sector's recapitalization. Consultations between the Bank and the Fund on the restructuring of RCI's debt have been close. Staff of both institutions held discussions, at times jointly, with the Steering Committee of the London Club to brief them on the current status of the macro-dialogue with the Ivorian Government. In addition, in the context of the proposed Bank financed economic management project, a major component will be to strengthen the debt management process in RCI.

Current Status of Financial Relations with the Bank

10. Cote d'Ivoire's financial relations with the Bank have, for the past two years, encountered serious difficulties in servicing debt on time. Although disbursements have never been suspended, arrears have reached on a number of occasions the 75 day point. After a 2 year hiatus Bank lending resumed in October 1989; to date, five operations, totalling \$418 million have been approved in FY90, of which \$80 million have already been disbursed under two SECALs. Nevertheless, Cote d'Ivoire's debt service situation is critical with about \$73 million currently overdue. Given the country's tight liquidity situation, the bulk of these funds is unlikely to be raised domestically. Efforts are underway to convince the French Government of putting in place a bridging loan. CCCE has approved on April 25 a CFAF 35 billion structural adjustment loan, with a first tranche of CFAF 20 billion. Discussions on financing requirements will be pursued in Washington around May 10 on the occasion of the visit of a senior Ivorian delegation.

DEBT & DEBT SERVICE REDUCTION
COTE D'IVOIRE
ALL FIGURES IN US\$ MILLION

Total Commercial Bank Debt: \$3,257 (end 1990)
Total Arrears: \$600

Instrument	Percent	<u>Debt Reduction Operation</u>		Relief
		Old Stock	New Stock	
Par Bond	50.00%	1629	1629	0
Discount Bond	17.00%	554	268	286
Buyback	33.00%	1075	95	980
Total Relief-->				1266

Predetermined Variables

Mkt Int Rate: 10.00%
Risk-free rate: 8.00%
SMP: \$0.08
Contractual Int Rt: 10.00%
Years of Bullet: 30
WB loan Int: 7.5%
Terms on WB Loan: (7/20)

Par Swap Results

Funds Reqd for Int Grnte: 66
Total Resources Used: 66
Implied SM Pr: \$0.08

Discount Swap Results

Face Value of Bond (1): 74
Face Value of Bond (2): 92
Face Value of Bond (3): 102

Negotiation Variables

Principle Collateralized ?
(1=YES, 0=NO)--> 0

Funds Reqd for Int Grnte: 22
Total Resource Used: 22
Implied SM Pr: \$0.08

Buyback Results

Yrs. of Int Grnte: 1.0
(either bond)

1st Round Buyback Price: \$0.08
No. of Tranches: 3
Stock Bought in each round: 358

Equivalency at given SM price

Exchange Ratio (1): 0.40
Exchange Ratio (2): 0.50
Exchange Ratio (3): 0.55

2nd Round Buyback Price: \$0.09
3rd Round Buyback Price: \$0.10

Par Bond Int Rt (1): 4.25%
Par Bond Int Rt (2): 5.00%
Par Bond Int Rt (3): 5.50%

Total Resource Used (NPV): 86
o.w. 1st Yr (current \$): 29
2nd Yr (current \$): 32
3rd Yr (current \$): 35

Summary of Past Due Interest

Total Past Due Interest:	600
Percent Down Payment:	8.00%
Amount of Down Payment:	48
Terms on Warrant:	(5/15)
Interest Rate:	0.00%
NPV of MIN Payment:	44
NPV of MAX Payment:	254

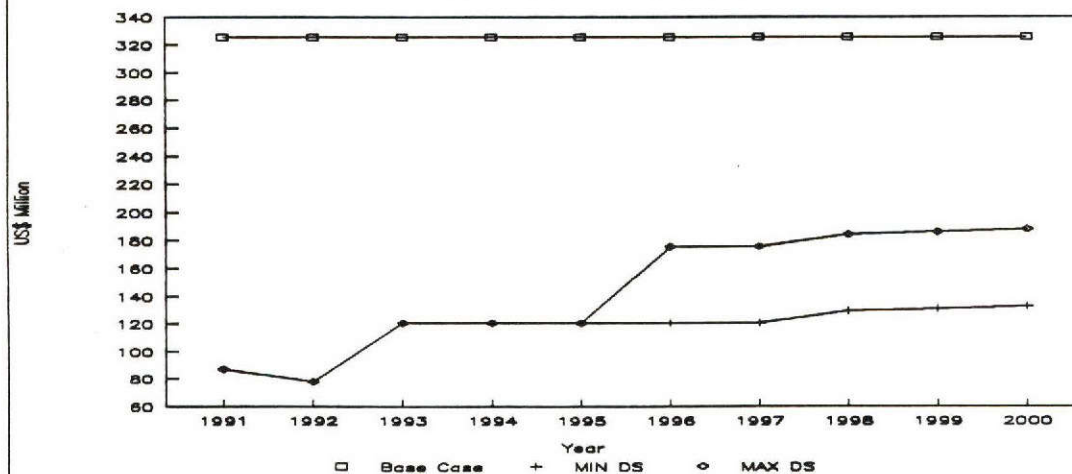
Official Loan Summary

Interest Rate On Loan:	7.50%
Terms on Loan:	(7/20)
First Year Disbursement:	107
Second Year Disbursement:	68
Third Year Disbursement:	75
NPV of all Disbursement:	231

Country's DS Profile

1991	87 (Incl PDI down pmt)
1992	78
1993	121
1994	121
1995	121
1996-2000	634

Debt Service Profile



OFFICE MEMORANDUM

900427032
cc. In Book 1

DATE: April 26, 1990

TO: Mr. Moeen A. Qureshi

FROM: S. Shahid Husain

EXTENSION: 39001

SUBJECT: CHILE - External Debt Management and the Role of the Bank

1. This note, prepared in response to your memorandum of April 20, 1990, summarizes the present thinking towards Chile's external debt management. A new government took office in Chile in mid-March 1990 and it is still in the process of developing economic policies of which the management of Chile's much reduced, though still significant, external debt will be an integral element.

Background

2. In the second half of the 1980s, Chile has been able to combine an enviable rate of growth (5 percent per annum in the 1985-90 period) with moderate rates of inflation and a viable external payments position. This performance is attributable to sustained macroeconomic adjustment policies buttressed by far-reaching structural reforms and the pursuit of debt reduction and debt to equity conversions, which has added to national savings and helped to limit fiscal expenditures and deficits; in the post-1987 period, Chile has also benefitted strongly from an improvement in its terms of trade. It has remained current on its external payments, albeit with the assistance of a series of new money and restructuring arrangements with commercial banks in 1983, 1985, and 1987. Despite a reduction of US\$8 billion in its external commercial bank debt since 1986--over half of the end-1985 commercial bank debt stock-- total external debt (US\$18 billion) is equivalent to about 75 percent of GDP and annual interest payments amount to nearly 7 percent of GDP or 19 percent of total exports. Assuming sound policies, the economy is projected to grow at its potential rate of just below 5 percent per annum over the medium term and register a significant improvement in its creditworthiness indicators. Chile's well established mechanisms for debt reduction and conversion remain in place and are expected to continue to function.

Projected External Financing Requirements

3. Chile's external current account deficit is projected at US\$1.5 billion in 1990 (5.8 percent of GDP), which is forecast to be financed by private capital inflows (including direct foreign investment) with minimal changes in reserves. The current account deficit, assuming continuation of sound macroeconomic policies, is projected at the equivalent of 3.5-4 percent of GDP in the medium term. From 1991 onwards, the economy faces substantial amortizations of commercial bank debt as the grace periods of the restructurings of the 1983-87 period expire. Thus, the gross external financing requirements

of the economy are projected to be substantial: in the region of US\$2.5-3 billion per annum over the 1991-95 period.

4. The authorities face a strategic choice between pressing for (i) a voluntary market oriented refinancing package, aided by IBRD supported cofinancing (including eventual use of the ECO program), bond issues plus other instruments made possible by an improved access to international capital markets or (ii) a long term rescheduling agreement. In either case, some further debt reduction could be a menu item although the form would depend on the overall financing package. As a result of past sound economic management and the substantial reduction in external debt, Chile's access to external capital markets has improved. Both long term supplier credits (related to expansion of direct foreign investment) and short term credit lines have increasingly become available to Chile. The latter (agreed with commercial banks in June 1989 for the following year) include voluntary credit lines of US\$0.5 billion in addition to US\$1.7 billion originally agreed in the 1983 restructuring. In June 1989, Chile obtained voluntary access to long term commercial banks debt for a cellulose investment project in the form of long term credit lines--the first in Latin America since the debt crisis. Thus, it may be possible to negotiate refinancing, bond issues, IBRD supported cofinancing and obtain other forms of voluntary access to the markets over the medium term. If this approach fails to yield the amount of financing necessary, a long term rescheduling accord would have to be considered.

Role of the IBRD

5. The success of debt reduction operations since 1985 has planted the seeds of its own extinction: external debt eligible for further reduction is highly limited. Of total debt of US\$18 billion, only about US\$6 billion is held by commercial banks and eligible. This debt trades at about 67 cents in the secondary markets. Thus, the secondary market yield on Chile paper is no worse than a junk bond in the domestic U.S. market--B grade paper. Debt is now concentrated in the hands of a reduced number of banks, some of which at least have long term interests in Chile.

6. Negotiations between Chile and the banks will commence later in 1990 with a view to obtaining the financing necessary over the medium term. The new Chilean authorities are still in the early stages of developing their strategy and are maintaining an active dialogue with the Bank and seeking its advice as to the best approach to external financing. Given the good relations between Chile and the banks, the country's excellent payments record and its conciliatory approach to its creditors, as well as the fact that banks have been reduced to a small, manageable number, the prospects of a refinancing/cofinancing approach appear encouraging.

7. In the past, the Chileans have shown themselves as highly capable debt negotiators and they are unlikely to require the active assistance of the Bank. If they opt for a strategy of refinancing and normal access, the Bank would be willing to offer some cofinancing opportunities. In the event some further debt reduction is put on the

agenda for discussions, the Bank will emphasize the importance of securing adequate financing over the medium term with enough contingency for adverse external shocks within the framework of a comprehensive approach supported by a medium term economic adjustment program as necessary conditions of its support. Particular attention will have to be paid to the materiality aspects of the debt reduction proposed.

cc: Messrs. Kashiwara (CFSVP); Bock (OPNSV);
Dubey (EAS); Bottelier (o/r), Tyler (LA4DR);
Shilling (CFSFA); Bery (o/r), Levy (o/r) (LA4CO)

SMitra:lh

OFFICE MEMORANDUM

900427034

see Mr. Boock

1

DATE: April 26, 1990

TO: Mr. Moeen A. Qureshi

FROM: S. Shahid Husain

Handwritten signature/initials

EXTENSION: 39001

SUBJECT: ECUADOR: Proposed Strategy for Debt Reduction

1. This note discusses the current status of negotiations on Ecuador's debt reduction, and the main tenets of the Bank's position on a number of strategic and tactical issues, as per your memorandum of April 20, 1990.

Background

2. Ecuador's debt to commercial banks was rescheduled several times between 1983 and 1986, under new money-type arrangements. As a result of the sharp decline in oil prices of 1986 and of the March 1987 earthquakes, which considerably reduced exports and government revenues, the country discontinued payments on interest and principal; a new money agreement negotiated later that year also collapsed. Arrears were also accumulated with bilaterals and in respect of commercial transactions. Between 1987 and mid-1988 (an election year), the economy deteriorated sharply, internal and external imbalances reached unprecedented heights, and no progress was made on the debt front. A new Government took office in August 1988, announcing an emergency economic program, including fiscal, monetary and exchange rate measures. This resulted in a sharp turnaround in public finances, laying the foundation for further adjustment. Interest arrears to commercial banks, however, continued to rise, reaching US\$0.8 billion by the end of the year.

3. During 1989 the Government took steps to normalize relationships with all its creditors. All arrears with official entities were eliminated, through payment or rescheduling (an agreement with the Paris Club was reached in September). Despite the "set-off" executed by Citibank against about US\$80 million of Ecuador's reserves deposited with it, the Government resumed partial interest payments to commercial banks, of approximately 30 percent of amounts due for the year, in August. Following the signing of a Letter of Intent with the IMF on the 1990 macroeconomic program, Ecuador announced that it would continue its policy of partial interest payments to commercial banks, on the order of 30 percent of interest due, for a total of US\$132 million. US\$26 million interest had been paid by March 31, 1990.

4. At the end of 1989, the commercial banks' debt eligible for debt reduction operations (the Steering Committee debt) amounted to approximately US\$5.6 billion of original principal and US\$1.2 billion in interest arrears, for a total of about US\$6.7 billion. This is equivalent to slightly over half of Ecuador's debt outstanding and

disbursed, that now stands at 117 percent of GDP, up from 71 percent in 1985. Total interest due on external debt in 1989 amounted to 9.9 percent of GDP (one of the highest values in the region), or roughly 50 percent more than in 1985. The secondary market price for Ecuador's debt has recently hovered around 15-16 cents to the dollar.

Bank Strategy on Debt Negotiation

5. The Ecuadoran Government has relied on Bank assistance and advice throughout its negotiations with the commercial banks. The World Bank's strategy on Ecuador's debt problems is guided by two main considerations: (i) the manifest need for a debt reduction operation, if the conditions for sustained growth of the economy are to be re-established; and (ii) the promising but as yet short track record of the Government in devising and implementing policies of economic stabilization and structural adjustment.

6. Conservative projections of Ecuador's external financing needs to 1997 indicate that unidentified requirements are likely to remain very high, in absence of a debt reduction operation, unless the growth rate of imports is reduced to an extent incompatible with positive growth of per-capita output. Under a scenario of moderate growth, no more than about 50 percent of interest to commercial banks could be paid, even with complete rescheduling of amortization. In addition, both past experience and present unwillingness on the part of Government and commercial banks indicate that a new-money/rescheduling strategy is not feasible. Debt reduction thus appears to offer the only realistic possibility of closing this financing gap and eliminating the debt overhang that provides a major impediment to sustained growth of private investment in the country.

7. Against this backdrop, the policies pursued by the current Government have permitted an increasingly productive dialogue with the Bank. The Government proceeded in earnest to implement stabilization policies upon taking office, well before seeking the advice and support of IFIs on these matters, and was rewarded by success. Considerable progress was made on the fiscal front, through a tax reform and a sharp reduction of oil subsidies; and more recently the intention to proceed with a comprehensive trade reform was announced. The active dialogue with the Bank on the whole range of policy issues facing the country has resulted in the submission, in January 1990, of a Letter of Development Policy, outlining a far-reaching program, including the time frame for introducing certain reforms. It is expected that further reform in the public sector and trade areas will be supported by adjustment lending from the Bank.

8. These considerations have guided the World Bank's stance on the negotiations between Ecuador and the commercial banks. Two major requirements have been impressed upon the Government and in representations with the Steering Committee: (i) that the debt reduction deal must be comprehensive, such that it would result in a resolution of the country's financing problems; and (ii) that, as debt

reduction can help restore growth only if accompanied by sustained progress on structural reform, Bank support would be phased over a three year period, and conditioned on achieving positive results in a number of areas of reform. In addition, in view of the vulnerability of Ecuador's balance of payments to commodity price shocks, the Bank, in order to minimize its risks, is also intending to press for the inclusion of symmetry if interest recapture clauses are to be part of a debt deal, and of constraints on the form of bonded instruments, particularly arguing against the use of bearer bonds. The Bank has also provided technical advice to the Ecuadoran Government, suggesting ways to make its proposals more flexible and attractive for the commercial banks, through expanded menu items.

9. Close coordination has been sought with other multilateral institutions on these matters. In this respect, the IMF, while agreeing on the desirability in principle of the comprehensiveness of a debt deal, is also anxious not to let this become an obstacle to the achievement of a more limited workout. This issue is under active discussion between Bank and Fund staff.

Debt Reduction: Recent Progress

10. Encouraging progress towards a negotiated solution has been made recently, following a timid beginning of the negotiation process. The Government introduced in August 1989 a proposal including a debt reduction operation, consisting of an option for creditors to exchange existing claims for either a par or a discount bond, with, respectively, 2.5 percent interest or 30 percent face value. The proposal, however, did not identify with precision the enhancements that might be available to support it, and the Steering Committee refused to accept it as a basis for negotiation.

11. Following the signing of the Letter of Intent with the IMF and of the Letter of Development Policy with the Bank in January 1990, Ecuador was able to identify US\$700 million of potential enhancements for a debt reduction operation. These would come from the World Bank (US\$200 million, of which US\$80 million in set-asides and US\$120 million in enhancements), from the IMF (about SDR70 million in set-asides and SDR60 million in enhancements), from bilateral donors (US\$150 million) and from Ecuador's own reserves. The indicative Bank support reflects current guidelines and the expected lending program of US\$800 million over FY91-93. After a protracted period of study of Ecuador's ability to pay by the economic subcommittee of the Steering Committee, and an inconclusive New York meeting between the banks and the Government, a first response was submitted by the Steering Committee in March 1990. The proposal was innovative in some respects, but fell far short of Bank requirements. The positive elements included the acceptance of a comprehensive framework, of the principle of debt reduction, the offer of more favorable interest terms, and the offer of a standstill agreement during the period of the negotiations. The proposal, however, did not identify the features of the operation beyond the first, limited debt reduction phase; furthermore, it was conditioned on substantially

increased levels of interest payments to commercial banks--that would be likely to severely undermine Ecuador's international reserve position--and strict constraints on the utilization of enhancements during the debt reduction phase. In addition, the proposal only envisaged an asymmetric oil-linked interest recapture clause.

12. On April 23, 1990, after consultations with the Bank and the IMF, the Ecuadoran Government replied to the Steering Committee, submitting a proposal that calls for a comprehensive agreement in three temporally distinct phases over a 27-month period. In the first phase, the country would buy back debt through an auction mechanism, committing up to US\$500 million of available enhancements. In the second phase, the remaining debt would be exchanged for either par (at 2.5 percent fixed rate) or discount (30 percent face value) bonds. Creditors that would have sold at least 70 percent of their claims during the first phase would be eligible to buy bonds with principal and a certain number of months guaranteed. Finally, in the third phase, the remaining debt instruments would be eligible for debt-equity conversions, subject to annual limits.

cc: Messrs./Ms. Kashiwaya (CFSVP); Rao (FRSDR); Selowsky, Barandiaran (LACCE); Bottelier (o/r), Rowat, Tyler (LA4DR); Bery (o/r), Augusto, Somensatto, Mitra (LA4CO); Morais (LEGOP); Collell (LEGLA)

LBarbone:fc

200427031
cc. As Booy

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION
OFFICE MEMORANDUM

DATE: April 26, 1990

TO: Mr. Moeen Qureshi, Senior Vice-President, OPN

THROUGH: Mr. W.A. Wapenhans, Vice-President, EMENA

FROM: Kemal Dervis, Director, EM2DR

EXTENSION: 3-2776

SUBJECT: MOROCCO - Country Note on IBRD Support for DDSR

Attached please find the note requested by your office regarding possible IBRD support to the recent agreement between Morocco and the London Club.

cc: Messrs. Hasan, El Maaroufi, Michalopoulos (EMNVP); Grais (EM2CO)

MOROCCO

IBRD Support for the DDSR

1. Background. Morocco's total external debt is around US\$ 20 billion or the equivalent of 90% of GDP and 300% of foreign exchange earnings. The share of debt held by multilateral institutions accounts for 23% of the total (of which 13% by the Bank and 5% by the Fund), that of the bilateral for 53%, while commercial banks hold 16% of the total, and the balance is in the hands of other private creditors. The share of commercial bank debt held by the London Club accounts, however, for over one quarter of interest payments on total external debt.

2. After a year of negotiations at the London Club, the Moroccan delegation and the steering committee of its creditor banks have initialled the week of April 9 an agreement that would enable the restructuring of Morocco's US\$ 3.2 billion commercial bank debt and open the door to debt and debt service reduction (DDSR). The deal is structured in two parts:

- (a) Part I: provided Morocco is in "good standing" with the Bank and the IMF (i.e.: having a Fund program or being actively seeking one), the banks will implement a long-term (20 years/10 years grace) bloc rescheduling on market terms (LIBOR + 13/16) with a separate treatment for Bankers' Acceptances which will have a shorter stretch-out (15/4) and also market terms. The margin will be retroactive as of the end of the previous agreement (January 1989). The banks provide waivers of prepayment clauses to allow debt buy-backs.
- (b) Part II constitutes a debt-restructuring scheme envisaging a menu of options for the banks to choose from, including reduced fixed-interest for a period of time, buy-backs, and new money. Part II requires Morocco to have reached an agreement with the Fund on an EFF and would become effective if the banks exercise the options provided for in the deal.

3. Evaluation of Part I. Part I of the agreement has the potential to provide significant cashflow relief to Morocco. The long tenor and grace periods of the rescheduling, combined with the steep discount available on the secondary market for Moroccan debt (62%), would relax the country's foreign exchange constraint provided resources are made available for buy-backs. The rate of return of Part I the deal will depend on the share of debt which will be restructured relative to that which will be extinguished through buy-backs. Assuming that about 20% of the debt can be retired (see para. 5) the rate of return can be expected to attain 25%-30%. The deal would be part of a concerted effort which comprises Paris Club rescheduling and the pursuit of adjustment supported by the IMF and the Bank, allowing Morocco to phase out of debt relief interventions and attain balance of payments viability by the mid-nineties. It would also stabilise expectations on the Moroccan economy encouraging private capital flows into the countries. The savings generated by

Part I of the deal are of the order of US\$ 60 million, or 6% of government budget expenditure on foreign debt. The resources that are thereby released would then be available for infrastructure and social spending and thus materially contribute to the country's development effort.

4. Evaluation of Part II. The prospects for an EFF before the end of the summer, triggering the implementation of Part II, are reasonably good. However, Part II of the deal represents at this stage only a moral commitment on the part of the commercial banks, although it could provide Morocco with further cashflow relief to the extent that some banks will accept interest rate reduction or swap their credits for equity participation in local enterprises. The deal does not envisage debt exchanges that would make the debt more inflexible. Furthermore a robustness and flexibility analysis shows that the financing plan remains adequate in the event of reasonable shocks, given the size of the flexible debt.

5. Proposed IBRD Support. Provided the country is implementing a satisfactory adjustment program with an adequate financing plan supported by the IMF and the Bank and benefitting from Paris Club rescheduling, the Bank should stand ready to support the implementation of Part I of the deal. The amount that the Bank could provide under the "set aside" guidelines to finance buy-backs, would be of the order of US\$ 120 million under the 25% adjustment lending guideline (corresponding to US\$ 110 m.) or the 10% of total lending (US\$ 130 m.). Combined with an equal amount from other sources, Part I of the deal would enable the retirement of almost 20% of total commercial debt, while the rest would be restructured as described in para. 2 (a).

6. In light of the outcome under Part I, the Bank will reassess the potential benefit of financially supporting Part II of the deal, notably with reference to the materiality and rate-of-return criterion. Provided these are satisfied and the adjustment program remains on track, the Bank could intervene with "additional" resources to be utilised to finance guarantee funds for interest reduction. The "additional" amount would represent about US\$ 200 million, following the guideline of 15% of the three-year lending program.

OFFICE MEMORANDUM

900427035

C. H. Booy

L

DATE: April 27, 1990

TO: Mr. Moeen A. Qureshi, Senior Vice President, Operations
Mr. Edward V. K. Jaycox, Vice President, AF4

FROM: Caio Koch-Weser, Director, AF4

EXTENSION: 34858

SUBJECT: NIGERIA -- Preliminary Note on DDSR Developments

1. This memorandum provides our preliminary thinking on the position we plan to take in the forthcoming negotiations for DDSR in Nigeria. In brief, the Nigerians have made a proposal for major debt service reduction to the London Club Steering Committee. The Committee has rejected the proposal, but is exploring alternatives. A buyback at a substantial discount is likely to constitute the core of any agreement. Most of the funding will likely come from Nigeria's reserves, but Bank and Fund financing may also be requested. Our position is: (a) to support the Nigerians' goal of seeking substantial debt relief from the banks, as part of a broader foreign financing strategy designed to secure adequate funding of the program and burden-sharing among creditors; (b) to support the seeking of an agreement that would provide a comprehensive program to deal with bank debt that is consistent with present secondary market discounts; (c) to participate, if asked, in direct financing of the package; and (d) in the meantime, to present the proposed US\$500 million Budgetary and Financial Policy Loan (BFPL) to the Board, including a clause reserving the right to subsequently use it as a Brady Plan operation.

2. Background. Intervening slippages notwithstanding, Nigeria's economic policies have been good since the adoption of the Structural Adjustment Program in 1986. These policies have been supported by two large policy-based loans from the Bank. BFPL, which would be the third policy-based loan, is scheduled to be negotiated next month. There have also been two stand-by arrangements with the IMF. The second stand-by was favorably reviewed by the IMF Board earlier this month. Negotiations for a new arrangement are scheduled to begin in two weeks. Paralleling the two earlier Bank-Fund programs, Nigeria has had successive, large rescheduling agreements with both the Paris Club and the London Club. Meanwhile, reflecting the dramatic decline in Nigeria's fortunes during the 1980s, the World Bank reinstated Nigeria's IDA eligibility in 1988 after a hiatus of over 15 years. This triggered donor interest. At an informal donors' meeting in January 1989, US\$600 million was pledged to fill the 1989 financing gap. Later in the year, the Consultative Group for Nigeria pledged an additional US\$600 million in new concessional assistance for 1990 and beyond. Broadly speaking, the economic policy framework is in place, and the Nigerians have proved themselves on the performance front over the past, very difficult, four years. In the circumstances, the key to sustainable long-term growth will be ensuring adequate financing for the program.

3. External Financing Needs. Real GDP growth of 4.5 percent per year will enable per capita consumption to grow by one percent per year and for investment to rise from the current level of 12 percent of GDP to 20 percent by the end of the decade. In turn, this will require import volumes to grow at 6.5 percent per year. Given Nigeria's overhang of external debt (US\$32 billion at end-1989, some 300 percent of exports and 100 percent of GDP) with no further relief from creditors, the external financing gap would exceed US\$3 billion per year. We believe that this can be met by a combination of reheduling, debt and debt service reduction, and project financing and donor assistance. Reschedulings from the Paris Club -- initially on "Cote d'Ivoire" terms and later on "Toronto" terms -- will be a major source of financing, as will further support from donors, along the lines secured in 1989 and 1990. Should Nigeria become eligible, ESAF could also play a role in the financing picture. Substantially reducing net transfers to the London Club creditors from presently scheduled levels of US\$650 million per year will also be essential.

4. Possible Proposals. In March, the Nigerians proposed to the Steering Committee that all London Club debt be replaced by 30-year bonds with 3 percent interest and 10 years of grace. The proposal contained no enhancements and hence required no financing. The risk-adjusted net present value of these bonds would be only 11-13 percent of face value, compared with the 25-30 percent at which the commercial debt is now selling in secondary markets. The banks rejected this proposal. Both sides are now exploring alternatives. A buyback is likely to form the cornerstone of any DDSR deal. Future discussions are likely to focus on how to price and fund a buyback and how to design suitable instruments for those banks that will not sell all their Nigerian exposure, possibly including debt equity swaps.

5. Funding Alternatives. The Nigerians have not asked for Bank or Fund financial support, although, during my last visit to Lagos, they hinted that such a request might be forthcoming. Under the Bank's DDSR guidelines, the potential amount available as set-asides would be US\$189 million (based on a 3-year SAL/SECAL lending program of US\$756 million). The potential available for interest reduction would be US\$420 million (based on a 3-year lending program of US\$2.8 billion). The most promising vehicle would be to use BFPL. The use of IMF ordinary resources is also a possibility; the high rate of return and special advantages of debt reduction at a substantial discount could offset the political objections to using IMF funds and could justify the relatively quick repayment terms. Based on the annual size of the existing IMF program, Nigeria would have access to up to US\$103 million per year as a set-aside for principal reduction and up to US\$442 million of additional resources for interest reduction. In the longer-term, ESAF resources are also a possibility. In terms of other financing sources, Nigeria also has access to US\$2 billion in cash, the proceeds of a sale last year of 20 percent of a major oil joint venture. These funds are needed for ultimate re-investment in the hydrocarbon sector, but actual spending is projected to be spread out over several years.

As the rate of return to money "invested" in debt reduction would be quite high, the government could afford to "borrow" from these funds and pay them back from the reduced debt service over the first few years of the program in time to keep to the scheduled hydrocarbon investment program. As a result, Nigeria may not need to make major demands on outside sources to finance their DDSR program.

6. Implications for Bank Risk and Exposure. Only about 10 percent of Nigeria's outstanding debt is owed to preferred creditors -- almost all to the World Bank. Nigeria has never drawn from the IMF. London Club debt is about 15 percent of the total and Paris Club debt over 50 percent. It is expected that in a DDSR agreement, most debt will be retired. However, even if all London Club debt is retired and even with the projected increased in Bank lending over the coming years, debt service to preferred creditors would only be 29 percent of the total by 1997. As to bank exposure, the set-aside would add nothing, and even a modest increment would be a very small percentage of Nigeria's total debt. Therefore, unless the request for Bank financial support of a DDSR program for Nigeria increases substantially, there are not likely to be major implications for Bank risk or exposure as a result of such a program.

7. Proposed Bank Strategy. We would like to see a comprehensive, medium-term solution to Nigeria's debt problem. DDSR from the banks will not only make a direct contribution to this objective, it will also be an essential pre-condition for obtaining other important elements of support such as concessional Paris Club terms. We expect a buyback to be a major element in the DDSR package. The discount should be in the range of 70 percent, corresponding to the current 25-30 percent of secondary market prices. The reduced flexibility in the structure of debt would be manageable. We are prepared to provide modest financial support. We would also support a contingency element in any remaining obligations, which would vary repayment terms with the oil price.

8. Next Steps. The co-chairmen of the banks' Steering Committee were in Washington this week. We discussed the balance of payments and possible instruments for a negotiated DDSR program. The next Steering Committee meeting is scheduled for May 9-10 in London, where the Economic Subcommittee's findings will be discussed. Assuming that committee members are so inclined, a follow-up meeting could take place later in May, with a full meeting -- including Nigeria and Bank/Fund participation -- in early June. We expect to remain in close contact with the co-chairmen and the Economic Subcommittee over the next month. We will also review the situation with Minister Falae when he visits Washington for the Interim Committee meetings in early May. Meanwhile, we are working with CFSFA on analyzing alternatives and their impact.

JETodd/om

cc: Messrs./Ms. Kashiwaya, Bock, Dubey, Shilling, Okonjo-Iweala.
[Misc: DDSR-MQ2]

OFFICE MEMORANDUM

Boover 27024

cc: Mr. Bock

DATE: April 27, 1990

TO: Mr. Moeen A. Qureshi

THROUGH: Mr. Attila Karaosmanoglu, Vice President, ASIVP *AK*

FROM: Bradley O. Babson, Acting Director, AS2DR *BAB*

EXTENSION: 72407

SUBJECT: PHILIPPINES - Second Stage Debt Reduction

1. This purpose of this note is to brief you on the current status of the Philippine debt reduction exercise, the GOP's likely future course of action, and our proposed position.

Background

2. The Philippines concluded their Phase I operation with the signing of the new money agreements in Tokyo at the end of March. The buy-back in January had retired \$1.337 billion of commercial paper at 50% discount; new money commitments were \$707 million. Following this operation and the debt equity, debt for debt, and debt for assets operations, the Philippines is left with about \$5.3 billion of commercial MLT debt which could be addressed under a second phase operation (out of a total MLT debt stock of around \$30 billion). The agreement under which Phase I was implemented explicitly allows for further DDSR operations. Resource limits on these were agreed: \$850 million in 1990 from official sources, and, if used, \$300 million in 1991. These limits would absorb potential official resources currently identified to finance such second stage operations. These amount to approximately \$1,050 million, of which an additional \$220 million could be provided by the IMF, \$350 million from the Bank (including \$50 million remaining from the Debt Management Program Loan), and \$480 million from the Japanese. However, access to the incremental Bank and IMF funds at present remains contingent on their use for debt service reduction, and the Japanese money has a similar, if unwritten, stipulation. Disbursement of these funds will be phased over time.

3. As a result of the Phase I program, the Multilateral Assistance Initiative, and conclusion of an EFF agreement with the IMF, the Philippines has adequate financing to meet reasonable needs through 1992. In the medium-term, however, the Philippine financing plan is likely to contain several key elements including the rescheduling of bilateral and commercial debt, to smooth the currently forecast "repayment hump". It is also likely to include the tapping of additional official resources for targeted DDSR operations, although these will not be major concerted exercises. The Philippine strategy will continue to reflect the specific configuration of its debt and will recognize the need to differentiate between types of creditors -- those whose exposure should be reduced and those whose involvement should be encouraged, an approach central to the Phase I operation.

Likely Philippine Proposal for Phase II

4. For the future, the Government intends to take advantage of selected opportunities currently offered by the market to reduce still further its debt and debt service obligations, and has asked for our advice. While it is premature to speculate about either the amounts or the modalities involved, it is our expectation that banks will be offered a number of equivalent options. One of those options would be further buy backs, another would be some form of par bond with reduced interest especially in the early years. Each bank would be left to decide which option is most attractive. Any second stage operation would likely: (i) be voluntary; (ii) differentiate between small and reluctant creditors and those from whom future flows or relief will be expected (as in Phase I); and (iii) be "partial", in order to achieve deep discounts with the limited resources, rather than spreading them thinly over the entire remaining commercial debt. Such an operation is unlikely prior to the second half of 1990.

Bank Position Regarding Phase II

5. We have explained to the Philippine authorities that, in conformity with the Bank's guidelines for DDSR support, our participation would be contingent on a number of pre-conditions, including the maintenance of a suitable macroeconomic framework (the current program with the Fund is encountering some difficulties), compliance with our policy-based operations, a satisfactory overall medium-term financing plan, and an acceptable debt reduction plan. Given the uncertainty as to the nature of the approach to be adopted by the Government, it is premature to spell out a specific position. However, we expect the following general issues to arise. First, the market may demand some degree of fungibility in the use of funds between buy backs and interest support. It is our understanding of current market sentiment that there is likely to be much greater interest in a properly priced buy back than in any other instrument. Mr. Kashiwaya and his staff are actively involved in evaluating the potential equivalence of alternative options. Second, in parallel, the GOP is reactivating the debt equity conversion program, and the relative roles of various schemes in the overall debt reduction program would need to be clarified. The Philippines are also currently pursuing limited buy-backs on a case-by-case basis, but the amounts involved are small. Third, we believe that the menu of options under consideration would not threaten the flexibility of the remaining debt, given the magnitudes involved. Furthermore, as the Philippines is not dependent on a single commodity export, there are no easy contingency schemes that could be introduced.

6. We would plan to brief the Board fully on our involvement, as soon as the Philippine plans are clearer. It would be premature to do so now. We will keep you current on future developments and seek your guidance on our involvement.

AS2

Cleared with and cc.: Mr. Shilling (CFSVP)

cc.: PHL Debt Working Group

OFFICE MEMORANDUM

900427030
cc: Mr Booy

DATE: April 27, 1990

TO: Mr. Moeen Qureshi, Senior Vice President, OPNSV

FROM: W. A. Wapenhans, Vice President, EMN

EXTENSION: 32676

SUBJECT: Poland - Debt and Debt Service Negotiations

1. Background. In January, 1990, Poland has embarked on a courageous reform program, and this will be a difficult year. After prices were liberalized, the rate of inflation shot up to 80% in January 1990. But the Government has implemented a tough stabilization program, and inflation was down to 6% in March. However, GDP may well decline by 10% and unemployment will almost certainly increase to well over 1 million. The sharp devaluation of the zloty in combination with a radical liberalization of the trade regime has given exports an important boost, while imports have decreased; we now expect a trade surplus of \$1 billion for 1990, but a current account deficit of \$1.2 billion even after the generous Paris Club rescheduling of all principle and interest owed during 1990 (and the first quarter of 1991).

2. Status of External Debt. Poland faces a massive external debt problem caused by excessive borrowing to fund non-viable projects during the 1970s, with a substantial amount of unpaid and capitalized interest adding to the stock of debt during the 1980s. Poland's \$40.6 billion external debt amounts to 80% of GDP, and more than 5 times convertible currency export earnings. As Poland implements a courageous reform program, there is a pressing need for resources to sustain the transformation to a market economy and the widespread restructuring of industry so urgently needed, as well as to implement a workable program to reduce debt and achieve creditworthiness in the medium term.

3. Medium-term balance of payments projections show a financing gap of about \$20 billion from 1990-1995, after taking into account likely multilateral and bilateral aid.^{1/} Even after 1995, by which time a substantial amount of debt service would have been rescheduled, a financing gap of about \$1 billion per year would remain. Interest due would amount to more than 7% of GDP, or about 30% of the fiscal budget. This would clearly not be a tenable situation.

^{1/} The projections take into account the impact of a likely reform of the CMEA non-convertible trade regime.

Cleared with & cc: Messrs. Hasan (EMNVP), Thumm (EM4DR)

cc: Messrs. Lari (o/r), Nouvel (o/r), Ms. Loos (EM4)
Shilling, Lamdany (CFS)

MLav/UZachau:mct

4. Status of Negotiations with Commercial Banks. The Government of Poland has not made debt service payments since October 1989, except on its \$1 billion trade facilities. Interest arrears for the last quarter of 1989 are \$145 million. The Government has recently met repeatedly with the Bank Advisory Committee and its Economic Subcommittee. The banks are looking for a temporary solution for 1990 and are currently asking Poland to pay its 1989 arrears as well as 15% of the interest due in 1990, with the remaining 85% being refinanced and consolidated with the existing trade facilities, which are to be replenished. The Government is prepared to pay 50% of its 1989 arrears and has requested a refinancing of all interest payments through March 1991 (the period of the IMF and Paris Club agreements), reminding them that the February 1990 rescheduling agreement with the Paris Club, which requires no payments in 1990, calls for equal treatment by other creditors. In addition, the Government asked that the banks enter into discussions with Poland concerning long-term debt relief.

5. Bank and IMF Support of Debt Reduction. On request, the Bank has indicated to the Government its support (in principle) of a debt and debt service reduction package with the commercial banks. The current IBRD lending program calls for commitments of \$2.66 billion for FY90 to FY92. Assuming that this includes possible "additional" funds for interest support, the Bank's guidelines would allow for set-asides of up to \$231 million and additional funds up to \$347 million. Support from the IMF could amount to up to \$330 million in set-asides and \$350 million additional funds. Thus, total IFI support could reach about one and a quarter billion dollars.

6. Outline of a Possible Package. The Bank has provided technical assistance to Poland in designing and discussing with the Government the features of illustrative debt and debt service reduction packages. A possible deal could consist of a partial buyback of about one-third of the debt and the exchange of the remaining debt at par into an interest reduction bond with a very low initial rate, which slowly increases up to market rates. The additional funds from the Bank and IMF would be used to collateralize interest payments and could be put into an escrow account, whose balance through the accumulation of interest grows to an amount sufficient to repay the principal of the bond at maturity. In this way, all of Poland's debt with the banks would be on commercial terms in 10 years from now. The implementation of such a package would imply an efficient use of Bank and IMF resources, and would not require a relaxation of the fungibility constraints in the current guidelines of the IFI's.

7. Adequacy of Financing Program and Role of Debt Reduction. About two-thirds of Poland's external debt and an even higher percentage of its debt service obligations over the next 5 years is to the Paris Club. Only slightly above 20% of convertible currency debt is owed to the commercial banks. For this reason, Poland's financing gap cannot be closed by a reduction of commercial debt and debt service alone. However, in the presence of concerted debt and debt service reduction from Poland's bilateral creditors (to ensure fair burden sharing, both the Paris Club and the CMEA), a commercial debt reduction package could close the remaining financing gap. In the long-term, it could also help Poland regain access to international capital markets.

8. Downside Risks and Contingency Financing. The management of the economic reform program as well as the CMEA trade conversion and the likely negative impact of the unification of Germany on Poland's exports pose substantial downside risks. Since it appears unlikely that banks would agree to contingency financing, it will

be particularly important to link Bank support for debt reduction to sustained adjustment supported by the Bank and the IMF as well as to an appropriate build-up of reserves.

9. Phasing and Frontloading. A commercial debt reduction deal is unlikely to be agreed upon before the first half of 1991. But for both 1991 and 1992, Poland's balance of payments shows significant gaps, even with bilateral debt and debt service relief. For this reason, a viable financing program will likely require some frontloading. The Government has already asked for a set-aside from the SAL, and is likely to request similar set-asides from upcoming loans in anticipation of a future agreement with the banks. Therefore, the degree of frontloading necessary at the time should not pose serious problems, depending of course on the exact timing of the debt reduction agreement and the track record that Poland will have established by then.

10. Inflexibility of Resulting Debt Structure. Since Poland will likely receive substantial support for debt reduction from the IFI's and its commercial debt accounts for only about 22% of its total convertible currency debt, a deal will likely be relatively comprehensive, but at the same time make a large portion, if not all, of the remaining commercial debt less flexible (e.g. by converting it into collateralized bonds). This problem will be more severe if commercial debt reduction will be negotiated before Poland obtains debt relief from the bilaterals, since in this case banks will be faced with the possibility of remaining financing gaps. In particular, they will want to protect themselves against the possible default even on their reduced claims by making their remaining claims as senior as possible. In this situation, one should resist potential pressures to convert debt into bearer bonds rather than registered bonds or to imply some kind of senior status for the new reduced claims.

OFFICE MEMORANDUM

DATE: May 3, 1990

TO: Mr. Moeen A. Qureshi, OPNSV

FROM: John Shilling, Manager, CFSFA

EXTENSION: 80004

SUBJECT: "Brady" Countries: Debt Workout Status Report

Attached are reports in tabular form concerning the status of debt workout dialogues between commercial banks and the countries listed in your April 20 note to the Operational Vice Presidents. These reports have been prepared on the basis of the various country reports submitted to you by the relevant Regional Departments in response to your request.

On the assumption that these tabular reports are acceptable to you and that you wish Mr. Conable to have them, I have prepared and attached a cover memorandum from you to Mr. Conable.

Attachments

cc: Mr. Kashiwaya (o/r)
Mr. Bock

AToft:lrd

~~As to~~
2) Mr. Qureshi

OFFICE MEMORANDUM

DATE: May 3, 1990

TO: Mr. Barber B. Conable, EXC

FROM: Moeen A. Qureshi, OPNSV

EXTENSION: 73665

SUBJECT: Follow-up to Board Discussion of IBRD Support for Debt and Debt Service Reduction

Following our recent meeting, I asked the Regional Vice Presidents to prepare preliminary notes on the positions they are thinking of recommending that the Bank take in forthcoming negotiations for eight countries which I believe are likely to pursue DDSR operations in the next 12 months, and for which Bank funding support might be sought. On the basis of those reports, I have asked my staff to prepare a tabular summary of the main points of the position. I will, of course, keep you informed, about DDSR developments concerning each of these countries.

Attachments

cc: Messrs. Stern, Thalwitz, Shihata, Fischer, Wood
Kashiwaya
Ms. Haug

AToft: lrd

May 2, 1990

BRAZIL

Status of External Debt and
Financing Needs

- . External debt totals \$114 billion (end-1989 estimated), of which \$74 billion is owed to foreign commercial banks and \$7.4 billion to Brazilian banks. Actual commercial debt eligible for DDSR operations may be closer to \$50 billion after further reconciliation. Total external debt is equal to 31% of GDP and 312% of exports.
- . In arrears since August 1989. Arrears on total external debt are about \$5 billion as of end-April '90.
- . Medium term bop gap is projected at \$21 billion for 1990-94. This excludes any projected reductions in debt and debt service.

Status of Dialogue with Commercial
Banks

- . Currently there is no dialogue with banks. Informal discussions have taken place. Resumption of negotiations would possibly be in June '90.
- . The following issues are likely to be critical in bank negotiations:
 - a) settlement of arrears
 - b) eligibility for official support under Brady Plan
 - c) merits of debt transformation package of Brazil.

Status of Bank Staff Proposals/Assistance

- . Advice being given on implications of DDSR instruments and experience under Brady DDSR operations in other countries.
- . Exhaustive report on debt transformation framework being prepared for the Government (yellow cover) to serve as analytical device in evaluating DDSR, D/E and other debt transformation instruments.

Available IFI Financing Support

Guidelines:

Bank: (New high case)

Set asides: \$800 million

Additional: \$1.2 million

IMF:

Set asides: \$375 million

Additional: \$770 million

Status of External Debt & Financing Needs	Status of Dialogue With Commercial Banks	Status of Bank Staff Proposals/Assistance	Available IFI Financing Support
. External debt totals \$18 billion (75% of GDP and 19% of export earnings). . Commercial bank claims reduced by \$8 billion (50%) since 1986. Now about \$5-6 billion. . Substantial reduction in number of commercial bank holding Chile claims. . Substantial amortization of commercial bank debt due 1991 onwards as grace periods of previous restructurings expire. . Medium-term long gap projected at \$12.5 - 15 billion for 1991-95.	. No formal advisory committee dialogue scheduled. . Government currently seek its options as: voluntary market-oriented refinancing package with IBRD supported cofinancing or concerted long-term rescheduling. . Relatively good standing of Chile in financial markets reflected an expansion in long-term suppliers credits and short-term credit lines. . In June '89 Chile obtained access to long-term commercial bank line of credit for an investment project.	. New Chilean debt team has recently commenced a dialogue with Bank staff. . Bank staff encouraging pursuit of voluntary market-oriented refinancing. . Explaining potential for Bank-linked project financing. . Internal discussion on possible use of ECO proceeding.	. Bank could provide \$86.8 million in set-asides and \$130.2 million in additional funds.

May 2, 1990

COTE D'IVOIRE

Status of External Debt	Status of Dialogue With Commercial Banks	Status of Bank Staff Proposals/Assistance	Available IFI Financing Support
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May 2, 1990

ECUADOR

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May 2, 1990

MOROCCO

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May 2, 1990

NIGERIA

Status of External Debt and
Financing Needs

- . External debt totals \$32 billion (100% of GDP and 300% of exports)
- . 32% of total debt is owed to commercial banks.
- . Medium term bop gap projected at \$18 billion for 1990-95.

Status of Dialogue with Commercial
Banks

- . Nigeria proposed in March 1990 that all London Club debt be exchanged into 30 year bonds with 10 years of grace and 3 percent interest rate. No enhancement included.
- . Proposal rejected by banks.
- . Both parties are now exploring alternatives.
- . Next Steering Committee meeting on May 9-10.
- . Meeting between parties (Bank and Fund staff will be present) likely in early June.

Status of Bank Staff Proposals/Assistance

- . Staff is focusing on comprehensive medium-term solution centered around a buyback at a discount around 70%.
- . Remaining obligations could be offered exchanged into instruments with contingency element linked to oil prices.
- . Staff engaged in analyzing alternative instruments and their equivalencies.

Available IFI Financing Support

Bank

Set asides \$189 million additional \$420 million.

Authorities have indicated that request for these funds might be forthcoming.

IMF

Expected that Nigeria will give serious thoughts to drawing on Fund program for DDSR, (Such drawing will make all resources for enhancement de facto additional).

Guidelines

- . Set asides \$309 million
- . Additional \$442 million

Memo:

- . Nigeria has substantial funds of its own set aside from oil operations which it may be able to use as well.

May 2, 1990

PHILIPPINES

Status of External Debt and
Financing Needs

- . Extend debt totals \$30.5 billion (69% of GDP and 282% of exports).
- . 35% of total debt is owed to commercial banks.
- . Substantial repayment obligations (incl. for commercial debt) concentrated in 1993-96.
- . Medium term financing gap projected at \$4.2 billion for 1990-95.

Status of Dialogue with Commercial
Banks

- . Phase I financing relief operation completed Feb '90: \$714 million new money and \$1.3 billion buyback at 50% discount.
- . No Advisory Committee dialogue envisaged in immediate future.
- . Government currently receiving numerous proposals from individual commercial banks.
- . Government contemplating limited targetted DDSR operations with focus on facilitating departure of banks wishing to "exit" (buybacks the preferred instrument) and restructuring external debt of public sector corporations. There will also be conversion instruments to make use of incremental enhancements and honor Philippine commitments for broader menu in Phase II.

Status of Bank Staff Proposals/Assistance

- . Encourage continued focus on prime issues e.g. maintenance of suitable macro-economic financial.
- . Encourage building on Phase I strategy of not depleting reserves, not "rigidifying" the commercial debt structure (e.g. though shallow discount bonds), and targetting DDSR operations towards banks with "identified" objective of "unloading" their Philippine claims.
- . FTA being provided on resuming debt-equity conversion program, methods for establishing "equivalencies" between instrument, and "soundings" the potential for market opportunities.

Available IFI Financing Support

- . For 2nd Phase DDSR operations.

Bank:

Set asides: \$50 million
(approved)
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IMF:

Set asides: \$90 million
(approved)
Additional: \$220 million

Memo:

Drawn for 1st Phase DDSR operations:

Bank:

Set asides: \$150 million
Additional: --

IMF:

Set asides: \$110 million
Additional: --

May 2, 1990

POLAND

Status of External Debt and
Financing Needs

- . External debt totals \$40.6 billion, (80% of GDP and 500% of convertible currency export earnings.)
- . 22% of external convertible debt is owed to commercial banks.
- . In arrears since October '89, except on \$1 billion trade facilities.
- . Medium-term bop gap projected at \$20 billion for 1990-95.

Status of Dialogue with Commercial
Banks

- . Numerous meetings with London Club held in last 7 months.
- . Banks seek temporary engagement in which '89 arrears would be cleared and 15% of interest due in '90 would be paid. Remaining 85% to be financed and consolidated with trade facilities.
- . Government prepared to pay 50% of '89 arrears, seeks refinancing of all interest through March '91, and dialogue on long-term relief.
- . DDSR agreement unlikely before first half of '91.

Status of Bank Staff Proposals/Assistance

- . Ongoing FTA focussed on developing understanding of implications of different DDSR instruments.
- . Financing support in principle indicated for DDSR operation.
- . Currently working on package design consisting of partial buyback, par exchange for remaining claims with temporary interest rate relief.

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Guidelines:

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May 2, 1990

BRAZIL

Status of External Debt and
Financing Needs

- . External debt totals \$114 billion (end-1989 estimated), of which \$74 billion is owed to foreign commercial banks and \$7.4 billion to Brazilian banks. Actual commercial debt eligible for DDSR operations may be closer to \$50 billion after further reconciliation. Total external debt is equal to 31% of GDP and 312% of exports.
- . In arrears since August 1989. Arrears on total external debt are about \$5 billion as of end-April '90.
- . Medium term bop gap is projected at \$21 billion for 1990-94. This excludes any projected reductions in debt and debt service.

Status of Dialogue with Commercial
Banks

- . Currently there is no dialogue with banks. Informal discussions have taken place. Resumption of negotiations would possibly be in June '90.
- . The following issues are likely to be critical in bank negotiations:
 - a) settlement of arrears
 - b) eligibility for official support under Brady Plan
 - c) merits of debt transformation package of Brazil.

Status of Bank Staff Proposals/Assistance

- . Advice being given on implications of DDSR instruments and experience under Brady DDSR operations in other countries.
- . Exhaustive report on debt transformation framework being prepared for the Government (yellow cover) to serve as analytical device in evaluating DDSR, D/E and other debt transformation instruments.

Available IFI Financing Support

Guidelines:

Bank: (New high case)

Set asides: \$800 million

Additional: \$1.2 million

IMF:

Set asides: \$375 million

Additional: \$770 million

Status of External Debt & Financing Needs	Status of Dialogue With Commercial Banks	Status of Bank Staff Proposals/Assistance	Available IFI Financing Support
. External debt totals \$18 billion (75% of GDP and 19% of export earnings). . Commercial bank claims reduced by \$8 billion (50%) since 1986. Now about \$5-6 billion. . Substantial reduction in number of commercial bank holding Chile claims. . Substantial amortization of commercial bank debt due 1991 onwards as grace periods of previous restructurings expire. . Medium-term long gap projected at \$12.5 - 15 billion for 1991-95.	. No formal advisory committee dialogue scheduled. . Government currently seek its options as: voluntary market-oriented refinancing package with IBRD supported cofinancing or concerted long-term rescheduling. . Relatively good standing of Chile in financial markets reflected an expansion in long-term suppliers credits and short-term credit lines. . In June '89 Chile obtained access to long-term commercial bank line of credit for an investment project.	. New Chilean debt team has recently commenced a dialogue with Bank staff. . Bank staff encouraging pursuit of voluntary market-oriented refinancing. . Explaining potential for Bank-linked project financing. . Internal discussion on possible use of ECO proceeding.	. Bank could provide \$86.8 million in set-asides and \$130.2 million in additional funds.

May 2, 1990

COTE D'IVOIRE

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THE WORLD BANK

March 19, 1991

Mr. Shilling:

Yes - I believe it is a good idea to do this, but Ngozi should check with Mr. Thahane as to whether it is appropriate to do so.

cc: Mrs. Okonjo-Iweala

MOEEN A. QURESHI
Senior Vice President, Operations

9103,9013

ROUTING SLIP		Date
		3/19/91
NAME		ROOM NO.
Mr. Qureshi		E-1241
URGENT	For Action/Comment	Per Your Request
Appropriate Disposition	Information/Discard	Returned
Approval/Clearance	Note And Return	See My E-Mail
File	Per Our Conversation	Signature/Initial
RE:		
REMARKS		
Do you want to circulate this to the Board members? <i>No. but it should appear fully with Yr. I believe it is a good idea to do it</i>		
From	Room No.	Ext.
John Shilling		80004

P-1862

to do. as. then. with Mr. Tolson say to whether it is appropriate.



Record Removal Notice

The World Bank Group
Archives
& Records Management

File Title Debt - Brady Proposals / Debt Reduction - General - Correspondence 03		Barcode No. 1661429		
Document Date 19 March, 1991	Document Type Board Record			
Correspondents / Participants				
Subject / Title Chairman's Summing Up - Board Discussion on Review of Progress Under the Program to Support Debt and Debt Service Reduction				
Exception(s)				
Additional Comments Declassification review of this record may be initiated upon request.		The item(s) identified above has/have been removed in accordance with The World Bank Policy on Access to Information or other disclosure policies of the World Bank Group. <table border="1"><tr><td>Withdrawn by A.May</td><td>Date November 11, 2023</td></tr></table>	Withdrawn by A.May	Date November 11, 2023
Withdrawn by A.May	Date November 11, 2023			

Office Memorandum

DATE: March 18, 1991

CONFIDENTIAL

TO: Mr. Moeen A. Qureshi, OPNSV

DECLASSIFIED

FROM: John D. Shilling, CFSFA (Through Mr. John Niehuss, CFSDR)

OCT 30 2023

EXT.: 80004

WBG ARCHIVES

SUBJECT: The Brady Review Paper: Indications from EDs Prior to the Board Discussion

1. We have now seen virtually all the EDs and discussed with them their preliminary views on the debt paper. From these reactions, we gather that tomorrow's discussion will be relatively quiet. Directors have found the paper "appropriately low key", although a number of Directors have wondered about what they see as a less concerned tone this year. Particularly Mr. Leung found that change uncalled for, and Mr. Landau queried whether such a change was justified.

2. The areas where Directors see a different tone in this paper compared to last year's paper include fungibility, downside contingencies, burden sharing, and inflexible debt.

3. Almost all Directors commented on the fungibility issue, stretching from the U.S., who thought we eventually got it right, to the Philippines/Brazil, who thought the presentation was almost factually incorrect. But more importantly, in between were a host of comments generally reflecting the view that the concerns raised last year are still valid. By the same token, however, these Directors expressed general understanding that the chosen approach was a politically sensible one, and that more would be achieved by not raising the issue in the abstract again, but awaiting an actual case where fungibility will be required. Mr. Landau was concerned that the lack of fungibility forced the IMF to lend incremental funds to Venezuela.

4. Also many Directors commented on the discussion of downside contingencies. It appears that the arguments in the paper on this subject are persuasive. Particularly the Canadians thought this discussion sheds important new light on the issue. Other Directors also agreed in general terms with the analysis, although several still thought the Bank should insist the debtors push for downside contingencies as a matter of principle or bargaining tool.

5. On burden sharing, at least the U.K. and Costa Rica indicated that they are going to emphasize the need for the Bank to protect its own interests, and on inflexible debt, particularly the French see a more relaxed tone this year.

6. The issues of arrears is going to be touched upon by a number of Directors, including the U.S., Japan, Germany, France, Canada, and Australia. These chairs all seem, to various degrees, to be worried the Bank is leaning too much toward endorsing arrears, while the Dutch and Philippines/Brazil apparently will come out on the other side.

7. A number of Directors (particularly Part II) noted that this year's paper does not touch upon the role of the Bank in the negotiations. They generally thought it appropriate to press for a more prominent position (although not to be part of the

negotiations) given the need to communicate the Bank's modalities for support, as well as management's obligation to inform the Board of important developments.

8. A number of countries (both Part I and II) will apparently be talking about official debt relief, although we do not anticipated any surprising statements on this issue.

cc: Messrs/Mme Kashiwaya, Stern, Thahane, Sandstrom, Bock, Grilli,
Okonjo-Iweala, Nielsen



Record Removal Notice

The World Bank Group
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& Records Management

File Title Debt - Brady Proposals / Debt Reduction - General - Correspondence 03		Barcode No. 1661429		
Document Date 17 March, 1991	Document Type Board Record			
Correspondents / Participants				
Subject / Title Draft opening statement, review of progress under the program to support debt and debt service reduction				
Exception(s)				
Additional Comments Declassification review of this record may be initiated upon request.		The item(s) identified above has/have been removed in accordance with The World Bank Policy on Access to Information or other disclosure policies of the World Bank Group. <table border="1"><tr><td>Withdrawn by A.May</td><td>Date November 11, 2023</td></tr></table>	Withdrawn by A.May	Date November 11, 2023
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Record Removal Notice

The World Bank Group
Archives
& Records Management

File Title Debt - Brady Proposals / Debt Reduction - General - Correspondence 03		Barcode No. 1661429		
Document Date 07 March, 1991	Document Type Letter			
Correspondents / Participants From: Barber Conable To: Frank Potter				
Subject / Title Debt and debt service reduction analysis				
Exception(s)				
Additional Comments Declassification review of this record may be initiated upon request.		The item(s) identified above has/have been removed in accordance with The World Bank Policy on Access to Information or other disclosure policies of the World Bank Group. <table border="1"><tr><td>Withdrawn by A.May</td><td>Date November 11, 2023</td></tr></table>	Withdrawn by A.May	Date November 11, 2023
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BARBER B. CONABLE
President

cc: Mr. Harshwaja
Mr. Boock
Mr. Dabney

May 25, 1990

Members, President's Council

Re: Criteria for Bank Support of Debt and Debt Service Reduction (DDSR)

Our discussion was wide-ranging and obviously inconclusive.

We all agreed, however, that we must review at an early stage the parameters of a debt and debt service reduction transaction in order to ensure that the Bank's development objectives and the criteria are to be met.

The Board paper made clear that we will not accept being confronted with a fait accompli, but states that:

"...management believes that certain clarifications and modifications should be made in the guidelines and that the Bank should take additional steps, together with the IMF, to ensure that both banks and member countries understand what these guidelines require, as they apply on a case-by-case basis."

I have not yet made a decision in what form these clarifications will be brought to the Board, and I take note of the general reluctance to use the paper we have reviewed.

As a first step, I would like to see at the start of each DDSR discussion a brief issues/position paper. Let us schedule the first position paper as soon as possible. Based on our review of a few specific cases in the President's Council, we will decide how to involve the Board.

Barber Conable

OFFICE MEMORANDUM

DATE: May 7, 1990

TO: Mr. Barber B. Conable

FROM: Moeen A. Qureshi *MAQ*

EXTENSION: 73665

SUBJECT: Criteria for Bank Support of Debt and Debt Service Reduction

1. Following the President's Council discussion of Venezuela on April 12, you asked for a note on acceptable criteria and conditions for Bank support of debt and debt service reduction. The overall criteria are, of course, set out in the various Board papers and Chairman's Summaries on this subject, and have been circulated to Operational staff in the form of a draft Operational Directive. Where I believe some members of the PC wanted further clarification was on the subjects of "inflexible debt", provision for contingencies, and use of bearer instruments.
2. The attached note, prepared by OPN staff in consultation with Finance, PRE, and Legal, provides a basis for further discussion on these topics. It is in the form of an overall statement of the guidelines to be given to borrowers. While I am personally reluctant to take the step of putting these points down in such a formal fashion--in part because we may need to go back to the Board before giving any such elaboration of the guidelines to borrowers--the Operations staff cannot continue to deal with some of these issues on an ad hoc case by case basis if they continue to be as contentious as in the past.
3. My own view is that we need to be careful about how extensive and detailed our criteria are, and the attached note reflects an approach based on a few key parameters. As the Board discussions and our own guidelines make clear, the Bank's concern is with the viability of the financing plan, not the specific terms and conditions of individual transactions. The bearer bond issue is likely to be seen by other parties to cross the line into "interfering" in the negotiations in most cases unless we present our position very carefully. In any event, I do not feel we will get very far in resisting the use of bearer instruments.
4. Once you are satisfied with the criteria on these points, I propose to have staff draw up a formal statement that can be given to the country debt negotiators.
5. We will also be preparing for your review individual country notes based on these criteria that set out the position we are taking in specific negotiations. This will be done, of course, by the interdepartmental Task Forces for each country. I am attaching for your information an overview of where things stand at the moment in key countries.

Attachments

cc: Members of the President's Council

World Bank Guidelines
for Lending in Support of
Debt and Debt Service Reduction

The World Bank provides support for debt and debt service reduction according to a set of guidelines established by the Bank's Board of Executive Directors. These guidelines are summarized below.

Country Eligibility

[Per Board papers and Chairman's Summary]

Amount of Support

[Per Board papers and Chairman's Summary]

Phasing of Support

[Per Board papers and Chairman's Summary]

Use of Funds (Set Asides vs. Additional Amounts)

[Per Board papers and Chairman's Summary]

Lending Criteria

IBRD lending for the purpose of debt and debt service reduction can only be justified as an exception from its normal lending for investment purposes if it makes a material contribution to the country's growth and development prospects. Moreover, since the Bank's support is provided within the context of a medium term, growth oriented adjustment program, the Bank needs to be satisfied that the overall financing package is adequate over the medium term. For these reasons, the Bank makes a careful evaluation of the financing package as well as the specific terms and conditions of its components before agreeing to lend in support of it. In doing so, the Bank gives greatest weight to the overall result in terms of the borrower's financing plan, not the specific structure or pricing of individual transactions, except to the extent that they call into question the overall viability of the financing plan and the adjustment program being supported by the Bank.

Debt and debt service reduction is thus seen as part of an overall financing package. The role it plays will, of course, vary from case to case, and it is not possible to state with precision what will or will not prove acceptable to the Bank's Board of Directors. However, in addition to the adequacy of the overall package, the Bank will consider the sustainability of the financing plan over time. Key considerations in this regard include:

- Provisions for adverse events. The estimates of medium-term financing requirements are, of course, based on a number of assumptions, and actual requirements are uncertain. The Bank's evaluation will include an assessment of the extent to which the financing plan is compatible with the additional financing requirements arising under reasonable downside scenarios [taking into account the scope for possible additional adjustment and slower growth].¹ Adequate reserves, contingent financing arrangements, and scope for future debt restructuring and new money arrangements will be important factors in the Bank's evaluation, particularly where the agreements include so-called "recapture" clauses.
- Flexibility in debt structure. The Bank has taken a cautious approach in supporting programs that involve securitization of the major part of existing commercial bank claims. Such conversion changes substantially the borrower's capacity to renegotiate its debt service obligations in an orderly fashion. For this reason, the Bank will look carefully at the amount and type of such securitization. The Bank specifically discourages the use of bearer instruments for this purpose.²

Waivers of the Bank's negative pledge clause

Creation of principal defeasance or interest collateral funds would constitute a violation of the "negative pledge" covenant in Bank loans by placing prior claims on those assets. The Bank has generally taken a highly restrictive approach in waiving these negative pledge provisions. However, as part of its overall support for borrowers' debt reduction programs, the Bank has indicated that it is prepared to waive the negative pledge clause specifically for assets used in DDSR operations that it supports, or for other operations that the Bank's Board may decide in exceptional cases to be in the interest of the borrower and the Bank.

1/ Square bracketed phrase (suggested by Finance) would go beyond most recent Board discussion and Chairman's Summary.

2/ Addition suggested by Finance Complex (without necessarily dictating precise wording): "In exceptional circumstances, the Bank is willing to support DDSR transactions including the use of bearer bonds where the legal documentation provides for a mechanism for orderly restructuring of debt service obligations in the event of an adverse material change in the external financing situation of the borrower."

May 2, 1990

BRAZIL

Status of External Debt and
Financing Needs

- . External debt totals \$114 billion (end-1989 estimated), of which \$74 billion is owed to foreign commercial banks and \$7.4 billion to Brazilian banks. Actual commercial debt eligible for DDSR operations may be closer to \$50 billion after further reconciliation. Total external debt is equal to 31% of GDP and 312% of exports.
- . In arrears since August 1989. Arrears on total external debt are about \$5 billion as of end-April '90.
- . Medium term bop gap is projected at \$21 billion for 1990-94. This excludes any projected reductions in debt and debt service.

Status of Dialogue with Commercial
Banks

- . Currently there is no dialogue with banks. Informal discussions have taken place. Resumption of negotiations would possibly be in June '90.
- . The following issues are likely to be critical in bank negotiations:
 - a) settlement of arrears
 - b) eligibility for official support under Brady Plan
 - c) merits of debt transformation package of Brazil.

Status of Bank Staff Proposals/Assistance

- . Advice being given on implications of DDSR instruments and experience under Brady DDSR operations in other countries.
- . Exhaustive report on debt transformation framework being prepared for the Government (yellow cover) to serve as analytical device in evaluating DDSR, D/E and other debt transformation instruments.

Available IFI Financing Support

Guidelines:

Bank: (New high case)

Set asides: \$800 million

Additional: \$1.2 million

IMF:

Set asides: \$375 million

Additional: \$770 million

Status of External Debt & Financing Needs	Status of Dialogue With Commercial Banks	Status of Bank Staff Proposals/Assistance	Available IFI Financing Support
. External debt totals \$18 billion (75% of GDP and 19% of export earnings). . Commercial bank claims reduced by \$8 billion (50%) since 1986. . Now about \$5-6 billion. . Substantial reduction in number of commercial bank holding Chile claims. . Substantial amortization of commercial bank debt due 1991 onwards as grace periods of previous restructurings expire. . Medium-term long gap projected at \$12.5 - 15 billion for 1991-95.	. No formal advisory committee dialogue scheduled. . Government currently seek its options as: voluntary market-oriented refinancing package with IBRD supported cofinancing or concerted long-term rescheduling. . Relatively good standing of Chile in financial markets reflected an expansion in long-term suppliers credits and short-term credit lines. . In June '89 Chile obtained access to long-term commercial bank line of credit for an investment project.	. New Chilean debt team has recently commenced a dialogue with Bank staff. . Bank staff encouraging pursuit of voluntary market-oriented refinancing. . Explaining potential for Bank-linked project financing. . Internal discussion on possible use of ECO proceeding.	. Bank could provide \$86.8 million in set-asides and \$130.2 million in additional funds.

May 2, 1990

COTE D'IVOIRE

Status of External Debt	Status of Dialogue With Commercial Banks	Status of Bank Staff Proposals/Assistance	Available IFI Financing Support
- External debt totals \$15.2 billion, equivalent to about 100% of GDP. - Commercial bank debt stands at \$3.1 billion, including \$600 million of interest arrears. RCI stopped servicing its M/LT debt in April 1987. Structure of bank debt: French banks: 57% UK banks: 12% German banks: 10% US banks: 8% Other: 12%	- RCI resumed dialogue with steering committee of banks in December of 1989. The Minister of Finance accepted the principle of resuming interest payments at 20% of contractual obligations (\$55 m. per year) pending completion of debt negotiations and provided BOP availability. No such payment has been made to date. - The steering committee is working on designing a comprehensive debt restructuring package at a price close to secondary markets (10 cents). - Main obstacles: large stock of non-accrual arrears and ICERC status for US banks; large discount for French banks with capital included reserves.	- Bank staff is working on a phased debt workout scenario in close consultation with IMF staff. Main terms: - downpayment of 8% of interest arrears and conversion of remaining arrears into LT warrants. - buyback of 1/3 of principal over 3 years at 8 cents on present value basis. - par bond debt exchange of 50% of principal with fixed rate of 5% over 3 years (1 year rolling guarantee). - discount bond debt exchange of 16% of principal (50% discount and 1 year rolling guarantee). Total official funding requirements: \$230 m. Total debt reduction \$1.3 billion over 3 years period.	5 operations totalling \$420 m. approved for FY90 (\$80 m already disbursed in 2 SECALS). - financial situation currently critical with \$73 million overdue. - IMF/WB funding for DDSR might be around \$80 m. each with remaining balance provided by bilateral donors.

May 2, 1990

ECUADOR

<u>Status of External Debt and Financing Needs</u>	<u>Status of Dialogue with Commercial Banks</u>	<u>Status of Bank Staff Proposals/Assistance</u>	<u>Available IFI Support</u>
• External debt totals \$9.7 billion (117% of GDP and 400% of exports) • 54% of external debt is owed to commercial banks • \$1.2 billion interest arrears. Partial interest payments (about 30% of interest due) have been made for about one year • Medium term bop gap projected at \$2 billion for 1990-95	• Initial meeting in August 1989 • Counterproposal by banks March 90: allowing partial buyback (\$700 million) now and acceptance of comprehensive framework, but no identification of features of program beyond first phase • New Government proposal end April 90: first phase with buybacks using up to \$500 m. Second phase: conversion of remaining into bonds (discount of 70% on interest rate of 2.5%) a la Mexico, but with a trigger level for eligibility of enhancements of 70% a la Costa Rica. • DDSR agreement likely by end 1990	• 3-year business plan with high case including/being preconditioned on debt reduction • Support in principle for DDSR, but need comprehensive and phased package.	Guidelines: Bank: Set asides \$ 80 million Additional \$120 million IMF: Set asides \$ 90 million Additional \$ 80 million

May 2, 1990

MOROCCO

Status of External Debt & Financing Needs	Status of Dialogue With Commercial Banks	Status of Bank Staff Proposals/Assistance	Available IFI Financing Support
- Total debt is equal to \$20 billion about (90% of GDP and 300% of export earnings). - commercial bank debt amounts to \$3.2 billion, including \$0.4 billion of bankers acceptances (BAs). - French banks hold about half of bank claims (US banks have reduced exposure to \$600 million at end-1989) - Medium term bop gap projected at \$0.3 billion for 1990-95.	- after a year of negotiations, final agreement on term sheet was reached on April 9, 1990. - steering committee was unwilling to agree on upfront comprehensive debt restructuring owing to absence of EFF and US bank's opposition regarding Morocco's Brady status. Instead a 2-part agreement was reached. - part 1: LT bloc rescheduling (20/10) with L + 13/16 and special treatment for BAs (15/4); waivers of prepayment clauses to allow voluntary buybacks. - part 2: following EFF, banks would have agreed to negotiate on a package which would include several options; new money, buyback and	Bank staff provided on-going technical advice during protracted negotiations. Should the restructuring package be fully implemented, the debt relief might lead to efficient use of IFIs' resources. However, given uncertainty regarding whether and how banks will participate in Phase 2, IFIs could not endorse the deal formally nor commit funding resources (materiality criterion) to Phase 1, but could to an appropriately designed Phase 2. NB: However, Morocco could use resources freed up by SAL or other Bank disbursements for Phase 1 buybacks without using up its Brady allocations.	Potential set-aside of the order of \$120 million. IMF funding of the same order of magnitude.

May 2, 1990

NIGERIA

Status of External Debt and
Financing Needs

- . External debt totals \$32 billion (100% of GDP and 300% of exports)
- . 32% of total debt is owed to commercial banks.
- . Medium term bop gap projected at \$18 billion for 1990-95.

Status of Dialogue with Commercial
Banks

- . Nigeria proposed in March 1990 that all London Club debt be exchanged into 30 year bonds with 10 years of grace and 3 percent interest rate. No enhancement included.
- . Proposal rejected by banks.
- . Both parties are now exploring alternatives.
- . Next Steering Committee meeting on May 9-10.
- . Meeting between parties (Bank and Fund staff will be present) likely in early June.

Status of Bank Staff Proposals/Assistance

- . Staff is focusing on comprehensive medium-term solution centered around a buyback at a discount around 70%.
- . Remaining obligations could be offered exchanged into instruments with contingency element linked to oil prices.
- . Staff engaged in analyzing alternative instruments and their equivalencies.

Available IFI Financing Support

Bank

Set asides \$189 million
additional \$420 million.

Authorities have indicated that request for these funds might be forthcoming.

IMF

Expected that Nigeria will give serious thoughts to drawing on Fund program for DDSR, (Such drawing will make all resources for enhancement de facto additional).

Guidelines

- . Set asides \$309 million
- . Additional \$442 million

Memo:

- . Nigeria has substantial funds of its own set aside from oil operations which it may be able to use as well.

May 2, 1990

PHILIPPINES

Status of External Debt and
Financing Needs

- Extend debt totals \$30.5 billion (69% of GDP and 282% of exports).
- 35% of total debt is owed to commercial banks.
- Substantial repayment obligations (incl. for commercial debt) concentrated in 1993-96.
- Medium term financing gap projected at \$4.2 billion for 1990-95.

Status of Dialogue with Commercial
Banks

- Phase I financing relief operation completed Feb '90: \$714 million new money and \$1.3 billion buyback at 50% discount.
- No Advisory Committee dialogue envisaged in immediate future.
- Government currently receiving numerous proposals from individual commercial banks.
- Government contemplating limited targetted DDSR operations with focus on facilitating departure of banks wishing to "exit" (buybacks the preferred instrument) and restructuring external debt of public sector corporations. There will also be conversion instruments to make use of incremental enhancements and honor Philippine commitments for broader menu in Phase II.

Status of Bank Staff Proposals/Assistance

- Encourage continued focus on prime issues e.g. maintenance of suitable macro-economic financial.
- Encourage building on Phase I strategy of not depleting reserves, not "rigidifying" the commercial debt structure (e.g. though shallow discount bonds), and targetting DDSR operations towards banks with "identified" objective of "unloading" their Philippine claims.
- FTA being provided on resuming debt-equity conversion program, methods for establishing "equivalencies" between instrument, and "soundings" the potential for market opportunities.

Available IFI Financing Support

- For 2nd Phase DDSR operations.

Bank:

Set asides: \$50 million (approved)
Additional: \$350 million

IMF:

Set asides: \$90 million (approved)
Additional: \$220 million

Memo:

Drawn for 1st Phase DDSR operations:

Bank:

Set asides: \$150 million
Additional: --

IMF:

Set asides: \$110 million
Additional: --

May 2, 1990

POLAND

Status of External Debt and
Financing Needs

External debt totals \$40.6 billion,
(80% of GDP and 500% of convertible
currency export earnings.)

22% of external convertible debt is
owed to commercial banks.

in arrears since October '89, except
on \$1 billion trade facilities.

Medium-term bop gap projected at
\$20 billion for 1990-95.

Status of Dialogue with Commercial
Banks

Numerous meetings with London
Club held in last 7 months.

Banks seek temporary engagement
in which '89 arrears would be
cleared and 15% of interest due
in '90 would be paid. Remaining
85% to be financed and
consolidated with trade
facilities.

Government prepared to pay 50%
of '89 arrears, seeks
refinancing of all interest
through March '91, and dialogue
on long-term relief.

DDSR agreement unlikely before
first half of '91.

Status of Bank Staff Proposals/Assistance

Ongoing FTA focussed on developing
understanding of implications of
different DDSR instruments.

Financing support in principle
indicated for DDSR operation.

Currently working on package design
consisting of partial buyback, par
exchange for remaining claims with
temporary interest rate relief.

Available IFI Financing Support

Guidelines:

Bank:

Set asides: \$231 million
Additional: \$347 million

IMF:

Set asides: \$330 million
Additional: \$350 million

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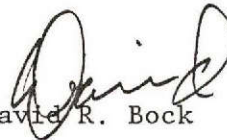
May 4, 1990

Mr. Qureshi

Moeen,

Re the criteria for DDSR, I spoke with Mrs. Haug to tell her that we would not get this to the President today. The point is to have a document which has been adequately reviewed and responded to by Finance, PRE and Legal. This review process is not yet complete.

I have also redrafted the attachment on criteria and have recirculated it to the Ad Hoc Debt Group for comments by Monday. I plan to have the revised version available for your signature Monday evening if you have a chance to look at it then.


David R. Bock

Attachments

May 4, 1990

DRAFT

Mr. Barber B. Conable

Moeen A. Qureshi

73665

Criteria for Bank Support of Debt and Debt Service Reduction

1. Following the President's Council discussion of Venezuela on April 12, you asked for a note on acceptable criteria and conditions for Bank support of debt and debt service reduction. The overall criteria are, of course, set out in the various Board papers and Chairman's Summations on this subject. Where I believe some members of the PC wanted further clarification was on the subjects of "inflexible debt", provision for contingencies, and use of bearer instruments.
2. The attached note, prepared by CFS staff in consultation with Finance, PRE, and Legal, provides a basis for further discussion on these topics. My own view is that we need to be careful about how extensive and detailed our criteria are. As the Board discussions and our own guidelines make clear, the Bank's concern is with the viability of the financing plan, not the specific terms and conditions of individual transactions. The bearer bond issue is likely to be seen by other parties to cross the line into "interfering" in the negotiations in most cases unless we present our position very carefully. In any event, I do not feel we will get very far in resisting the use of bearer instruments; the most we are likely to achieve is to prevent our resources from being used directly for this purpose.
3. Once you are satisfied with the criteria on these points, I intend to have staff draw up a formal statement that can be given to the country debt negotiators. This statement would set out the Bank's general guidelines as well as its position on these specific issues.
4. Per your request, we will also be preparing for your review individual country notes based on these criteria that set what position we are taking in specific negotiations. I am attaching for your information an overview of where things stand at the moment in key countries.

Attachments

cc: Members of the President's Council

World Bank Guidelines
for Lending in Support of
Debt and Debt Service Reduction

The World Bank provides support or debt and debt service reduction according to a set of guidelines established by the Bank's Board of Executive Directors. These guidelines are summarized below.

Country Eligibility

[Per Board papers]

Amount of Support

[Per Board papers]

Phasing of Support

[Per Board papers]

Use of Funds [i.e. fungibility]

[Per Board papers]

Lending Criteria

IBRD lending for the purpose of debt and debt service reduction is provided under a special exceptions clause in its Articles. Such lending can only be justified if it makes a material contribution to the country's growth and development prospects by releasing resources for productive investment. Moreover, since the Bank's support is provided within the context of a medium term, growth oriented adjustment program, the Bank needs to be satisfied that the overall financing package is adequate and viable over the medium term. For these reasons, the Bank makes a careful evaluation of the financing package as well as the specific terms and conditions of its components before agreeing to lend in support of it. In doing so, the Bank gives greatest weight to the overall result in terms of the borrower's financing plan, not the specific structure or pricing of individual transactions, except to the extent that they call into question the overall viability of the financing plan and the adjustment program being supported by the Bank.

Debt and debt service reduction is thus seen as part of an overall financing package. The role it plays will, of course, vary from case to case, and it is not possible to state with precision what will or will not prove acceptable to the Bank's Board of Directors. However, in addition to the adequacy of the overall package, the Bank will consider how viable the financing plan is over time. Key considerations in this regard include:

- Provisions for adverse events. The estimates of medium-term financing requirements are, of course, based on a number of assumptions, and actual requirements may be quite variable. Adequate reserves, contingent financing arrangements, and scope for future debt restructuring and new money arrangements will be important factors, particularly where the agreements include so-called "recapture" clauses.
- Flexibility in debt structure. The Bank has taken a cautious approach in supporting programs that involve securitization of the major part of existing commercial bank claims. Such conversion changes substantially the borrower's capacity to renegotiate its debt service obligations in an orderly fashion. For this reason, the Bank will look carefully at the amount and type of such securitization. The Bank specifically discourages the use of bearer instruments for this purpose [and will not permit the proceeds of its loans to be used to enhance such claims.]

Waivers of the Bank's negative pledge clause

Creation of principal defeasance or interest collateral funds would constitute a violation of the "negative pledge" covenant in Bank loans by placing prior claims on those assets. The Bank has generally taken a highly restrictive approach in waiving these negative pledge provisions. However, as part of its overall support for borrowers' debt reduction programs, the Bank has agreed to waive the negative pledge clause specifically for assets used in DDSR operations that it supports, or for other operations that it believes to be in the interest of the borrower and the Bank.

The World Bank

Washington, D.C. 20433
U.S.A.

MOEEN A. QURESHI
Senior Vice President, Operations

May 2, 1990

Mr. Conable

Re: Note on Debt Reduction operations for
your luncheon with David Mulford

Herewith a note which has been drafted by David Bock and provides a very useful and illuminating analysis of why the Bank is more rigorous than the Fund when it comes to looking at Debt Support operations. I thought that this would be helpful for your conversation with David Mulford. We are not just being "bloody-minded" but we have to take into account some institutional concerns which are different from those of the Fund. This also explains, at least partially, what David Mulford perceives -- mistakenly, in my view -- as our proactive stance.



I want to follow up on the comment made to you by David Mulford to the effect that the difference between the Bank's approach to the Brady Initiative and that of the Fund is a matter of "activism" on the part of the Operations Complex. Naturally, I resent the allegation that the Bank is behaving irresponsibly. But more importantly, this comment indicates a lack of understanding on the part of the US Treasury as to the real reasons why the two institutions have taken somewhat different approaches to a common concern.

In the case of the Fund, the Brady Initiative is being implemented by increasing access to Fund resources, with a specific though legally indirect link to debt and debt service reduction. While this may be a somewhat artificial activity for the Fund, the resources being provided are like all other IMF resources, namely additions to the country's reserves, which the country then uses to effect debt reduction. In the case of the Bank, we are making specific loans that are explicitly for the purpose of debt and debt service reduction. Since this is not an activity that normally falls under the specific investment projects clause of the Articles, we have to justify such lending under the exceptional circumstances provisions, hence we have to satisfy ourselves about the materiality of benefits in terms of growth and increased investment.

This has two important implications. First, the Bank more than the Fund has to be concerned with the adequacy of the financing package over the medium term. If the financing is not adequate, growth may not take place and the material benefits for investment will not be realized. The IMF need not be as concerned with medium term effects; if debt reduction is part of a one-year program, the only thing that would prevent the Fund from supporting it (apart from conditionality) is the Fund's own policy objective of tying debt reduction support to the EFF -- something that the Board of the Fund can deal with on a case by case basis.

Second, if the financing package negotiated by the country is inadequate, the Fund can insist on a change in the program, including further adjustment on the part of the country. If financing is too tight to permit growth, that alone would not prevent the IMF from supporting the program of debt reduction. But it could prevent the Bank from doing so, again because of the materiality criteria.

In other words, it is significantly more difficult for the Bank to make loans for debt and debt service reduction than it is for the Fund to increase access for this purpose. This is not a matter of management style. It is anchored in the legal differences in the two institutions. For this reason also our approach to the review of progress under the Brady Initiative was different from that of the Fund. In dealing with financing assurances, the Fund was able to throw the problem back onto the country. In our case, we need to stress up-front the importance of adequate financing. This has a tendency to come across as more interventionist than the Fund, but the alternative is either to let ourselves be "rolled" on lending standards or block transactions that are already negotiated on the grounds that they do not meet the materiality test. We do not have the alternative of simply lending for debt reduction operations as though they were isolated investment projects, detached from the overall medium term adjustment program and financing plan.

My job and those of my colleagues in Operations would be much simpler if we did not have to deal so explicitly with these issues. But we do. This is a matter both of the Articles and of credit risk management, not "activism". It is ironic that the Treasury perceives the Fund to be more supportive of the Brady Initiative than is the Bank. A close look would show that the Fund management is actually more reserved about the program and -- if asked -- probably grateful that they do not need to make the same type of explicit, medium-term appraisals of debt reduction programs that we do. Certainly they do not need to expend as much management energy defending their support for the Initiative on an ongoing basis.

Finally, if the US insists on reconvening the discussion of April 10, in order to fix what they continue to find unsatisfactory about the outcome of that meeting, they risk reopening the whole debate about the role of the Bank in lending for debt and debt service reduction. This could be extremely counterproductive from their standpoint.

May 1, 1990

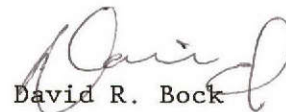
Mr. Qureshi

Moeen,

✓

A few quick points:

1. Barber will be having lunch with Mulford on Friday. I think we need to get him well briefed on the institutional differences between the Bank and the Fund in supporting the Brady Initiative. Please have a look at the note I gave you yesterday morning in this regard.
2. I don't know if you have the background to Ernie's comment in yesterday's PC about the use of IDA reflows, but it has significant implication for how we deal with Zambia. Apparently, IDA commitment authority is subject to a modest bulge at the moment due to higher liquidity. This "bulge" could be used to provide some additional support in clearing arrears rather than simply increasing IDA's general commitment authority.
3. I have sent comments back to Joe Wood on the Debt for Nature Swaps paper. I will let you know how this comes out.
4. I don't think that the papers on the status of debt negotiations can be sent to the PC in their present form. I have asked Jed Shilling to summarize them, focussing only on the position that we are taking in specific negotiations and deleting all of the background discussion. The memoranda are simply too inconsistent in approach to be forwarded as a package to the PC and will invite all sorts of nitpicking comments about inconsistency in our stance in country negotiations.
5. I have spoken to LAC about the Venezuela paper; a revised version should be on your desk tomorrow.


David R. Bock

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OCT 30 2023

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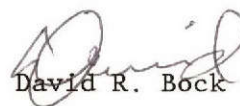
April 27, 1990

Mr. Qureshi

Moeen,

I have spoken to John Neihus and Mary Chavez in the Treasury today (Senior DAS for Policy and Special Assistant to Mulford, respectively). I think I succeeded in pouring some oil on troubled waters. I have advised John that further discussion in the Board is likely to result in the US losing more than it gains and that they should wait until Monday when tempers are cooled before they do anything. Finally, I told John that a dispassionate reading of the Summing-Up would reveal that the US has 80% of what it was after.

Also, I have spoken to several EDs offices (UK, Canada, US) on the Ecuador question. They have been impressed by my explanation of the facts. As you may know, Mulford included reference to Ecuador in his letter to the G7 Deputies.


David R. Bock



Record Removal Notice

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File Title Debt - Brady Proposals / Debt Reduction - General - Correspondence 03		Barcode No. 1661429		
Document Date 07 March, 1991	Document Type Memorandum			
Correspondents / Participants From: Al-Sultan, Baijal, Benachenhou, Funna				
Subject / Title Revised Chairman's Suming Up - Review of progress to support debt and debt service reduction analysis				
Exception(s)				
Additional Comments Declassification review of this record may be initiated upon request.		The item(s) identified above has/have been removed in accordance with The World Bank Policy on Access to Information or other disclosure policies of the World Bank Group. <table border="1"><tr><td>Withdrawn by A.May</td><td>Date November 11, 2023</td></tr></table>	Withdrawn by A.May	Date November 11, 2023
Withdrawn by A.May	Date November 11, 2023			

OFFICE MEMORANDUM

DATE: April 23, 1990

TO: Moeen A. Qureshi, OPNSV

FROM: John D. Shilling, Manager, CFSFA

EXTENSION: 72773

SUBJECT: Status of Debt Reduction Negotiations

Attached is a summary status of the debt reduction negotiations for countries with negotiations in process, which you may want to forward to Mr. Conable in response to his request of April 16.

I propose to substitute a version of this for the Weekly Brief, only updating the information as the situation changes and time stamping each entry. I would also add the information on secondary market prices and other generally interesting material. This could then be circulated more generally on a regular basis.

The highly confidential and time critical information that was also included in the Weekly Brief would be sent directly to you immediately, perhaps in a special format. Do you agree?

cc: Messrs. Kashiwaya, Bock, Taylor, Elwan

JDS Shilling:rmc

Tour-Horizon of Present Stage of Debt Reduction Negotiations
April 20, 1990

The following is a summary of the current state of negotiations between selected member countries and their commercial creditor banks.

ARGENTINA

The Government intends to make a presentation to its commercial banks steering committee in May in anticipation of an IMF Board meeting which will address Argentina's Fund program. CFS has been assisting the Government's debt team in preparing for the meeting with the banks. The Government debt team is the subject of some controversy. The President has apparently given a distinguished former Minister of Economy from the Right the mandate to negotiate a resolution of the commercial bank debt problem, but it is not clear if he enjoys the full support of the rest of the economic team or if he is up to the task. The commercial banks have noted that the reserves of the Government are on the upswing, an event which has prompted them to call for resumption of negotiations.

BOLIVIA

The Government is evaluating the viability of the most recent proposal by its financial advisor, Merrill Lynch. This proposal envisages effectively buyback at 11 cents on the dollar without having to obtain permission (waivers) from the remaining commercial creditors. The funding for the operation would be in the neighborhood of \$30 million, which Bolivia hopes to raise from the IDA Debt Reduction Facility (up to \$10 million) and from official donors.

BRAZIL

The Government has recently appointed a senior official from the diplomatic service to deal with the commercial bank debt issue. Although there has been much political rhetoric surrounding the subject, there has not yet been substantive progress. The banks have recently visited Brasilia and have expressed concern that the Government may be on the verge of defaulting on short-term trade facilities, a step which would be viewed gravely by the banks. CFS and LA-1 will be working in the next two weeks to prepare a briefing paper for the Government which will serve to describe the recent experiences of Mexico, Costa Rica, the Philippines, Chile and Venezuela in external debt negotiations and to present for the Government's consideration a range of options available to it in the coming discussions with bankers.

CHILE

The chairman of the Bank Advisory Committee, Manufacturers Hanover has recently been in Santiago counselling the Government to move carefully and to ensure that any external debt operation they pursue be highly voluntary in nature, so as to preserve the good will of the banks which has been built up in the past several years. CFS has recently visited with Manufacturers Hanover and has had preliminary discussions on the possibility of Bank support for Chile's external debt program. Meetings with Government officials will be held in the coming two weeks to cover the issue further.

COLOMBIA

The Government has not yet revealed its intentions with regard to the refinancing of commercial bank amortizations falling due in 1991 and 1992. CFS has discussed with both the Government and its leading bank (Chemical Bank) the prospect of the Bank supporting the 1991 - 1992 financing program through the use of the ECO program. Those discussions will continue next week.

COSTA RICA

The Government has now received responses from almost all of its banks to its offer to buy-back debt for cash or exchange it for collateralized bonds. The responses have been more than 70% in favor of cash redemption. The Government has commitments for about \$113 million in funding for the operation and is prepared to use its own reserves and bridge financing from Mexico and Venezuela to conclude the deal if necessary. It is hoped that the deal can be closed by May 7th, but it will require a lot of luck, considering all the commitments needed by closing.

COTE D'IVOIRE

There has been no negotiation between the Government and the commercial banks on a possible debt and debt service reduction package. A recent IMF mission is completed with the primary objective to put the Fund program on track. However, this mission has thrown some light to the government in terms of a strategy of a possible DDSR emphasizing on two key issues: (i) The DDSR operation ought to be phased due to constraints in the availability of official funds required for enhancement. (ii) The menu would possibly consist of a buyback, a par bond and a discount bond. The official sector considers it appropriate that Phase I should consist of only a buyback for an upfront debt reduction.

ECUADOR

The Government is in the midst of negotiating a Brady package with the commercial banks. The Commercial Bank Advisory Committee made a proposal to Ecuador about two weeks ago which amounts to a one-year stand-still agreement during which the Government would enjoy restricted rights to buy-back its debt with official resources and surplus oil revenues. The proposal also calls for the Government to make interest payments greatly in

excess of the levels which the Fund estimates are realistic. The Government, the Bank and the Fund (less strong than us) have all reached the conclusion that the current bank proposal is not acceptable, and that a great deal more work will be needed to arrive at a practical agreement. The Government intends to issue a counterproposal next week to the chairmen of the Bank Advisory Committee. Ecuador has a rescheduling agreement from October 1989 with the Paris Club covering 1990, and the bilateral follow-up negotiations are progressing smoothly. The second review of the IMF standby was in March; a multi-year agreement is planned.

HONDURAS

The Honduran Government is committed to clear payment arrears and meet its future multilateral obligations and seek a comprehensive solution in which the Bank, IMF and IDB will be paid jointly. Arrears to these institutions will reach US\$247 million by May 31, 1990 of which the Bank's share is US\$147 million. The Bank, through the Consultative Group, has been assisting the Government to assemble bridge loans to clear the arrears by May.

MOROCCO

The Steering Committee of commercial banks (co-chaired by Citibank and BNP) and the delegation from Morocco have recently agreed to restructure Morocco's US\$3.2 billion commercial bank debt. They have further agreed on an open door on debt and debt service reduction. The term sheet is awaiting ratification by the Government and the banks' committee and is expected to be signed by end-June 1990. The agreement comprises of: (a) Long-term rescheduling of US\$2.8 billion with 10 years grace and 20 years maturity at market rate (LIBOR + 13/16); (b) Long-term rescheduling of US\$0.4 billion with 4 years grace and 15 years maturity at the same market rate (both a & b being conditional upon Morocco being in good standing with the IMF). If an agreement on a EFF with the Fund is reached before the end of 1991, the banks are prepared to participate in debt exchanges. However, there is no clear-cut commitment on this issue except a moral understanding.

MOZAMBIQUE

After an initial meeting in June 1989 and interim consultations with the Bank, the IMF, and among themselves, the Bank Advisory Committee (BAC) sent a debt and debt service reduction proposal to Mozambique in late January 1990. That proposal contained three elements: (a) a buyback (on a voluntary basis) of an unspecified proportion of the debt; (b) a debt to equity or debt to local currency swap program, and (c) a contractual arrangement for servicing any debt remaining after a buyback and debt swap programs would have been concluded. The Government of Mozambique has not yet officially responded to the BAC, but the Governor of the Central Bank has indicated his general willingness to discuss the details of buyback and conversion proposals. He has, however, added the caveat that he does not wish to enter into any contractual agreements on behalf of the Government of Mozambique which it would be unable to honor.

NIGERIA

At the request of the Nigerian government, a meeting was held on March 19-20, 1990 with the BAC at which the Government presented a debt service reduction proposal. The Nigerian proposal is to restructure all bank debt (medium and long term, letters of credit, and nonreschedulable debt) into 30 year bonds with 10 years grace at 3 percent interest. The Government indicated that it would meet its April debt service payment, as agreed under the 1989 rescheduling agreement, but beginning in May payments would be made according to the proposed new schedule. Bankers reacted calmly to this proposal, but offered no concrete response. However, bankers asked Bank and IMF representatives present at the meeting if the IMF would agree to a program with arrears to the banks and if the Bank would lend into arrears. The Bank and IMF representatives did not provide a direct response to the question.

PHILIPPINES

The Philippines was the second country to pursue a Brady type debt reduction operation. After agreeing on a term sheet for new money and a buyback offer with the Bank Advisory Committee last fall, the Philippines bought back US\$1.3 billion at 50 cents on the dollar in January and received US\$700 million in new money from commercial bank creditors in February. In addition, they were granted waivers to spend up to US\$850 million in 1990 on debt and debt service reduction. They are presently discussing internally the strategy for this second phase of the strategy. CFS has been asked to provide technical advice in this field. Presently they are leaning toward offering a new buyback as well as a low interest instrument on an entirely voluntary basis. Negotiations with banks on this may start in May.

POLAND

Poland has accumulated interest arrears to the commercial banks since the last quarter of 1989. The Government has told the banks that it wants to negotiate a Brady type debt and debt service reduction package, but so far the banks are talking only about 1990. Two crucial issues will be long-term debt and debt service reduction from the Paris Club, which holds 70% of the debt, and burdensharing with the CMEA. In February 1990, the Government reached a 13-month Stand-By agreement with the IMF, which is expected to be superseded or followed by a 3-year EFF. Subsequently, the Paris Club agreed on a generous rescheduling agreement, covering all of 1990 and the first quarter of 1991, and requiring no payments at all during 1990. The Paris Club also set up a working group with the Government and the IMF to explore long-term solutions of the debt problem.

URUGUAY

The Government proposed a Brady package in September 1989, at which time the banks adopted a wait-and-see attitude until the new government took office (March 1, 1990) and the country entered into a Standby agreement

with the IMF. Both of those conditions have been substantially met; legislation related to the adjustment package has been passed by Congress, and the Government is in the process of resolving the remaining outstanding issues with the Fund, related to the measurement of the fiscal deficit. The Government feels that the Standby could be approved in May, and is seeking IBRD/IMF support for its proposed cash buyback of US\$1 billion (total commercial debt \$1.6 billion) using \$450 million. The price of Uruguayan paper is currently 42 cents, down from 55 in September and 60 previously. A two-part \$140 SAL is currently being carried out, which could help support the proposed operation. The Government will resume discussions with the Steering Committee in early May.

VENEZUELA

The Government is working with the different working Groups on the terms of the different instruments and is aiming at finalizing the Term Sheet by the first week of May. Beyond the details of the structure of each instrument (new money, temporary interest relief, discount par exchange like in Mexico, and buybacks), certain important issues are still unresolved: (i) When, how, and at what price the buyback will take place? The answer to these questions will depend on the banks response to the request for waivers. Venezuela needs to obtain waivers on the sharing clauses before it can go ahead with the buyback. The request will be endorsed by the BAC and will be sent to the banks together with the Term Sheet. (ii) It is unlikely that the BAC as a whole will endorse and market the package, which will require a stronger than usual marketing effort on the part of Venezuela to avoid free riders. (iii) It is not clear how the Government is planing to deal with the free riders, and (iv) The amount of resources required for enhancements will not be known until all the banks choose among the different instruments.

OFFICE MEMORANDUM

DATE: April 20, 1990

TO: Regional Vice Presidents

FROM: Moeen A. Qureshi *MAQ*

EXTENSION: 73665

SUBJECT: Follow-up to Board Discussion of IBRD Support for Debt and Debt Service Reduction

1. During the recent review of the Bank's program to support debt and debt service reduction (DDSR), Directors generally supported a strengthened approach by the Bank to ensuring that the program objectives are adequately met. Accordingly, it was agreed that the Bank would seek to make clear at the outset of the negotiations the parameters and conditions for its support. In order to do this, we need to initiate a more formal approach to the formulation and communication of the Bank's position in specific country cases.

2. Please send me as soon as possible preliminary notes on the position you propose to take in forthcoming negotiations for the following countries: Nigeria, Ecuador, Chile, Cote d'Ivoire and Poland. These position notes should be brief and cover the main issues noted in the Chairman's Summing Up (see attached). They would be expected to form the basis of staff presentations to the advisory committee at the outset of the negotiations. I would also like to have short notes on the position we expect to take vis a vis the Morocco agreement with its banks and the next stage of the Philippines debt reduction program. Drafting of these notes should make full use of the country task forces. Please review them with Mr. Kashiwaya and his staff before forwarding them to me. I will expect Mr. Kashiwaya and his staff to be responsible for briefing regional staff on the Bank-wide experience to date, as well as their understanding of the Directors' views on the Bank's role on the negotiations.

Attachment

cc: Messrs. Conable, Fischer, Kashiwaya, Shihata, Wood, Dubey, Bock, Shilling

International Bank for Reconstruction and Development

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SecM90-471/2

FROM: Vice President and Secretary

April 20, 1990

EXECUTIVE DIRECTORS' - APRIL 10, 1990

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

Revised Chairman's Summing Up

Attached is a revised version of the 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). It incorporates a number of specific changes requested by an Executive Director, plus minor editorial improvements. Deletions are marked by a [--] and insertions underlined.

In the absence of requests for further modifications, to be communicated to the Vice President and Secretary or the Deputy Secretary, by close of business, Wednesday, April 25, 1990, this revised version of the Chairman's Summing Up will be transmitted to the Development Committee.

Distribution:

Executive Directors and Alternates
President
Senior Vice Presidents
Senior Management Council

This document has a restricted distribution and may be used by recipients only in the performance of their official duties. Its contents may not otherwise be disclosed without World Bank authorization.

Legend

____ - new text

[--] - text deleted

[--] ____ - text deleted and replaced

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 issues need to be ~~[done]~~ reviewed 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 ~~[interpretation of the guidelines]~~ 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]~~ complex and time consuming and that there were important issues that needed to be addressed on an ongoing basis. Directors reiterated that Bank support for debt and debt service reduction would be decided on a case-by-case basis taking into account the strength of the medium term economic program for adjustment, the severity of the debt burden, the scope for voluntary, market-based operations, the medium term financing plan, and the potential benefits from Bank support, particularly for investment and growth. Directors ~~[emphasized]~~ reaffirmed the importance of assuring that debt and debt service reduction programs supported by the Bank ~~[provide]~~ contribute to a viable financing plans over the medium term and that these programs be appropriate to the needs and circumstances of the particular country. ~~[There are central issues to be addressed in the debt and debt service reduction agreements and]~~ Directors ~~[stressed]~~ urged 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]~~ take these

points into consideration 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 be 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] and 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 or further domestic adjustment were mentioned by some.

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 [~~would~~] 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 [~~in some cases~~]. 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 and~~] constitute part of an overall adjustment program and a financing plan supported by the Bank [~~and are deemed by the Bank to which~~] and confers material benefits to the country. Staff noted that such benefits should facilitate investment for productive purposes in the country.

6. Directors noted that although a phased approach to providing Bank resources for debt and debt services 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. [~~Front loading 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.~~] Among the important factors to be considered in a justification for front loading would be a strong adjustment program, a satisfactory track record of adjustment, a clear need in terms of the debt reduction program and financing plan, and/or the potential of the proposed package to have a favorable impact on investor expectations.

7. Directors ~~[noted the complications in negotiations caused by the]~~ discussed the impact of 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 noted that the lack of fungibility has not constrained the agreements reached so far and has encouraged the expansion of options in financing packages. The consensus is to leave this guideline unchanged, ~~[but it was noted that the Board is prepared to consider a more flexible use of enhancement funds on an exceptional basis where this can be clearly justified. [in the particular case.]]~~

8. With respect to the nature of the Bank's role in the negotiations, Directors agreed that it was important to maintain [a] 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 Directors were generally in favor of a stronger role than had been the case thus far.]~~ There was a discussion aimed at clarifying the Bank's advisory role. Accordingly, ~~[they]~~ most Directors supported [management's] proposals 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 guidance during the course of negotiations about the adequacy of the package under discussion, including whether contingencies are sufficiently provided for. 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.]~~ These Directors also supported the view 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 the adequacy and appropriateness of the financing package over the medium term and the provisions for contingencies. Other Directors stressed that the Bank's guidance to negotiations not run counter to 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 when commercial banks engage [engaging] 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, making traditional measures of burden sharing inappropriate. However, the package from the commercial banks should make an equitable contribution 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] the medium term financing plan.

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. Most Directors [generally] supported the Bank's present [restrictive] practice of providing waivers of its negative pledge requirement, [other than] for the assets providing collateral in Bank supported programs. Other 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 for further elaboration on this complex issue, 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 the near future. In [addition,] response to a request from several Directors, a Board seminar will also 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]~~ Important issues will, of course, be promptly brought to Directors' attention.

THE WORLD BANK

April 11, 1990

Mr. Bock
Mr. Shilling

Please see some changes. Discuss
with me if you have problems.

MOEEN A. QURESHI
Senior Vice President, Operations

FORM NO. 75
(6-83)

THE WORLD BANK/IFC

ROUTING SLIP		DATE:
		April 10, 1990
NAME		ROOM NO.
Mr. Qureshi		
Ms. Haug		
<i>Mr. Bork / Shilling</i>		
<i>Please source changes. Discuss</i>		
<i>with me if you have problems</i>		
		<i>MOD 4/12</i>
APPROPRIATE DISPOSITION	NOTE AND RETURN	
APPROVAL	NOTE AND SEND ON	
CLEARANCE	PER OUR CONVERSATION	
COMMENT	PER YOUR REQUEST	
FOR ACTION	PREPARE REPLY	
INFORMATION	RECOMMENDATION	
INITIAL	SIGNATURE	
NOTE AND FILE	URGENT	
REMARKS:		
Here is the revision, taking into account the final discussion in the Board. Do you want to clear it before we send it to Secretary's for distribution?		
FROM:	ROOM NO.:	EXTENSION:
John Shilling		72493

April 10, 1990

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

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 interpretation of the guidelines.

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 ongoing basis. Directors emphasized the importance of assuring that debt and debt service reduction programs supported by the Bank provide viable financing plans over the medium term and that these programs be appropriate to the needs and circumstances of the particular country. These are the 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.

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 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 reserve ~~levels~~.

4. A number of Directors noted the dangers in spreading official enhancements too thinly, thereby creating a structure where the commercial debt is relatively inflexible. Use of buybacks would help avoid this problem. However, it was also pointed out that debt conversions provided

important advantages as part of an overall package of debt and debt service reduction in some cases. 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 that they ^{confer material benefits and contribute} ~~are~~ part of an overall adjustment program and financing plan supported by the Bank.

Directors noted that although a phased approach to providing Bank
6. ~~While recognizing the importance of front loading to concluding~~
uses for debt and debt service reduction had been considered to be the norm
~~some agreements, a number of Directors emphasized that front-loading of~~
The Guidelines, frontloading had been a feature of the agreements reached thus far.
~~resources in the agreements reached thus far should be regarded as~~
~~exceptional. A phased approach should be the norm. Nevertheless, I~~
~~recognized that some flexibility would continue to be required, especially~~
in this area
~~where other creditors were making strong efforts to satisfy the Bank's~~
to achieve
~~overriding concern for adequate and appropriate financing arrangements.~~
Front loading would be justified where there is a satisfactory track record
helps mobilize
of adjustment, where it ~~contributes to~~ 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. The consensus is to leave this guideline unchanged, but to note that the Board is prepared to consider a flexible use of enhancement funds where this can be justified in the particular case.

8. With respect to the nature of the Bank's role in the negotiations, Directors agreed that it was important to maintain a careful balanced approach. 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, Directors were generally in favor of a stronger role than had been the case thus far. Accordingly, they 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 guidance during the course of negotiations about the adequacy of the package under discussion, including whether contingencies are sufficiently provided for. 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 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 when engaging 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. Director generally supported the Bank's present restrictive practice on providing waivers for its negative pledge requirement, other than for the assets providing collateral in Bank supported programs. In response to requests from most Directors, management agreed to provide a paper addressing the 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.



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Exception(s)				
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Withdrawn by A.May	Date November 11, 2023			

WORLD BANK/INTERNATIONAL FINANCE CORPORATION/MIGA
OFFICE MEMORANDUM

Date: April 9, 1990
To: Files
From: John D. Shilling, Manager, CFSFA
Extension: 72773
Subject: IMF Board Discussion of Debt Paper, April 9

Directors discussed the paper from 3:30 to 8:00 PM today without concluding. Staff response, further discussion, and the Summing Up are now scheduled for Wednesday morning at 10:00 AM.

For the most part, the Directors were appreciative and supportive of the paper. They reiterated the importance of a strong program for any workout and were generally satisfied with progress so far, but in varying degrees. They were concerned about delays in reaching agreements and about the lack of new money. Most Directors supported the general thrust of the paper's recommendations seeking adequately funded programs, strong and clear statements of the "parameters" for the expected agreements from the IMF, limited frontloading where justified by a track record, a preference for some phasing, willingness to tolerate carefully constrained arrears to commercial banks within programs, and willingness to be flexible in allowing some fungibility on a case by case basis.

The major exception was the US ED, who took strong exception to the paper. He asserted that it did not give sufficient recognition to the progress achieved so far, that it proposed far too active a role for the IMF, and that the recommendations for modifications in the guidelines would be counterproductive. He stated that the current structure had been responsive, flexible, met commercial bank needs, and managed to obtain both new money and debt reduction. He was surprised by the changes recommended. In particular he took issue with the assertions that programs were underfunded (they should take account of DFI and Capital reflows, and proposed changes would make them more rigid and underfunded); that the form and structure of agreements should be reviewed (the US Treasury view is that exchanges are more efficient than buybacks, which should have only a limited role, and that bonds, even bearer, don't lead to unacceptable inflexibility); that the IMF should exercise a stronger role (other than clearly stating and defending the required gap, it should say clear of the negotiations); and that there should be more fungibility (the current rules had not harmed any deal and assured more interest support instruments which had lower cost and less risk to the IFIs. In addition, a change would raise problems with a delicately agreed strategy and wouldn't be fair to those who had already made deals

under the current rules). The Japanese director mildly supported some of these views, but other directors did not seem sympathetic.

The issue of official debt was also discussed. Several developing country EDs expressed concern for those Middle Income countries with primarily official debt who could benefit from neither the Brady plan nor Toronto terms. They hoped more concessional official debt relief could be made available for these countries, perhaps building on the recent Cote d'Ivoire and Poland agreements and on multi-year arrangements. It was argued that if the debt overhang theory held for commercial debt, it also applied to official non-concessional debt. Creditor country EDs expressed some sympathy, but expressed their view that the Paris Club was making a substantial contribution and the commercial banks needed to do their share, although the concept of burden sharing was becoming more difficult to realize. The US objected strongly to even discussing the question of bilateral official debt relief in the Board. It was to be dealt with the Paris Club itself. This reaction was also to the papers to the Development Committee.

cc: Qureshi, Iwala, Kashiwaya, Bock, Haug, Stern, Wood, Rao, Shihata, Scott, Goldberg, Morais, Thalwitz, Fischer, Linn, I. Husain, Nielsen

4/9 Read to Q by telephone

DECLASSIFIED

OCT 30 2023

CONFIDENTIAL
April 9, 1990

WBG ARCHIVES

Meeting with U.S. Executive Director

Mr. Qureshi

Moeen,

I had another meeting with Pat Coady and Mark Cox today in order to head off any major problems vis a vis tomorrow's discussion. I outlined how I saw the discussion shaping up, noting that we were not seeking major changes in the guidelines, etc.

Pat said he had received firm instructions from the Treasury to oppose any change in the guidelines. Despite my efforts to assure him that our suggested modifications were really questions of emphasis and nuance, he remains unhappy with the tone of the paper and its recommendations. He said that the Bank and the Fund are seeking a veto over the financing arrangements and he finds that completely unacceptable.

I told him that I was somewhat frustrated by his response. In my view, the paper is simply describing what it is we have to do to make the Brady Initiative successful. The critical elements in the paper are no different from the sorts of arguments used by the Treasury vis a vis the banks in order to ensure that the financing packages make sense. Also, we are not seeking a veto but in any event we have a perfectly legitimate right to say what can and cannot be done with our money. There is no particular reason why the Bank should waive its independence of judgment as to the adequacy of financing packages (or any other elements of the deal for that matter).

Pat has asked to speak first. Unless he is simply trying to intimidate me in advance, I would expect him to come out with a fairly strong, negative comment on the paper and a firm resistance to even the very modest modifications in the guidelines that are recommended. I do not think that this position will be supported by any of the other Directors except perhaps Mr. Shiratori. A strong intervention by the U.S. seems likely to provoke strong reactions on the part of the other Directors, which will thus undermine my efforts to forge a consensus along the lines set out in the draft Chairman's Summing Up.

I would appreciate your advice as to whether to drop the first point in my introductory statement. Why say all of those soothing words only to be totally repudiated by the U.S.? The major substantive change to be made in the Summing Up would be on fungibility, where the existing statement would need to be watered down to a willingness to take up this issue again in a specific future case if necessary.


David R. Bock

cc: Messrs. Kashiwaya, Shilling

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OFFICE MEMORANDUM

OCT 30 2023

WBG ARCHIVES

CONFIDENTIAL

DATE: April 7, 1990

TO: Mr. Moeen A. Qureshi, OPNSV

FROM: David R. Bock, CFSDR (Through: Mr. Koji Kashiwaya, CFSVP)

EXTENSION: 72942

SUBJECT: The Brady Review Paper; Indications from EDs Prior to the Board Discussion

1. We have now seen virtually all the EDs and discussed with them their preliminary views on the Brady Review paper. Most Directors have welcomed the paper and complimented it for its clear and candid analysis. Apart from the U.S. and Japanese EDs, Directors have been generally favorable to the recommendations made in the paper. Please find attached short memos on each of the meetings we have had with the EDs. Also attached are a draft opening statement and Chairman's summing up.

2. The U.S. will probably be critical of the approach taken in the paper. As you know, they think it is critical of the Brady Initiative and its application thus far. The Japanese may join the U.S. and express similar views, although in a more muted fashion. The other EDs have expressed broad agreement with the recommendations.

3. The role of the Bank in the negotiations will be a key topic in the Board discussion and may cause some problems. The U.S. has apparently lobbied against a strengthened role for the IFIs in the negotiations. They are arguing for no change in the approach taken thus far. They may find support among other EDs, but for different reasons. Several Part II Directors queried whether more intensive Bank involvement might lead to more risk and possibly ending up on the side of the commercial banks. On the other hand, the Latin EDs (and to some extent the French) will press for a stronger role for the Bank - and one that clearly sides with the countries - if only to balance the U.S. "hands off" approach.

4. In discussions with the EDs, we have tried to stake out a middle of the road position: we do not want the Bank dictate the terms of the agreements, but the Bank should not be taken for granted either. We have recommended that the Bank should make clear up front the parameters for Bank support, which would focus on "adequate and appropriate" financing, including a general need to deal with downside contingencies. In return for this tough line on the fundamentals, the Bank needs to be in a position to be flexible on fungibility and front loading, on a case by case basis.

5. Everybody, apart from the U.S., has expressed at least some support for fungibility as recommended, i.e. on a case-by-case basis. A number of EDs will talk about the lack of new money and its implications for burden sharing and development. We have responded that we see the new money issue as part of the requirement of adequate financing; I did not feel we could go further at this stage than to acknowledge it as a problem, though we may be pressed for a more forthcoming response at the Board meeting on what to do about future resource transfers to these countries.

6. I sense that the Part II Directors will focus on new money, burden sharing and tax/regulatory changes. The reasons for new money are obvious. They appear to want to use burden sharing as the club for better discounts, on the grounds that to do otherwise would be bailing out the banks. They also hope that free riders can be clobbered through tax and regulatory changes, hence again improving the terms of the negotiations.

7. On balance, I do not expect major problems on Tuesday. Most EDs seem to feel that the jury is still out on the Brady Initiative. They accept that progress is being made and that there have been no great calamities thus far. But they also want to keep up the pressure to make the plan work and to begin thinking about future financing. They thus read the paper as appropriately balanced between being supportive and yet appropriately cautious about the future.

cc. Messrs. Karaosmanoglu (ASIVP); S. Husain (LACVP); Jaycox (AFRVP);
Wapenhans (EMNVP); Stern (FINSV); Wood (FPRVP); Shihata
(LEGVP); Thalwitz (PPRSV); Fischer (DECVP); Shakow (SPRDR);
Dubey (EAS); Shilling, Flannery, Toft (CFSFA).

DBock:ya

OFFICE MEMORANDUM

DATE: April 7, 1990

TO: Files

FROM: David Bock 

EXTENSION: 72942

SUBJECT: Meeting with Mr. Lim on Brady Review

1. On April 4, I met with Messrs. Lim, Carling and Halliday on the review of progress under that Brady Initiative. Mr. Lim was mainly concerned with two points: first, he would like to see a return to something akin to the old critical mass approach as a way of getting sufficiently deep discounts to deal with the problems cited in the paper. I gathered that he would be in favor of a strongly interventionist approach to make certain that gaps were closed, arrears avoided and adequate financing made available. In this connection, he expressed considerable concern about the problems of burden sharing. Is it appropriate? Adequate? Are official resources being used to bail out banks? Second, Mr. Lim remains opposed to the use of IDA resources for buybacks. He believes this is a waste of resources that can only benefit the banks and provides no near term benefit to the countries that are already in longstanding default on their commercial bank loans. He plans to suggest that these funds should be used for guarantees on new money rather than buybacks.

2. On the first point, I tried to point out the problems of the critical mass approach in an environment where the banks are well-reserved, but I did not sense that I had moved Mr. Lim in his views. I also gave our standard arguments for the IDA facility, again to little avail.

3. Mr. Carling sees the heart of the problem to be the failure of new money, and he questioned why the paper did not build on it. I pointed out that the new money is part of the issue of adequate financing packages. We "build on" this problem by stressing the importance of adequate financing as the sine qua non. How the banks contribute is up to them and the country. He also expressed concern that some politically important countries might qualify for the program too easily; I think he had Brazil in mind, where the program is still in early stages. On the degree of Bank involvement in the negotiations, he noted that there is a spectrum of possibilities and it was unclear from the paper what we had in mind. He personally favored more of a "steering" of the negotiations. I told him that we were still intending to remain arms length, but be tougher on standards up front while being flexible on front loading and fungibility.

/c

4. Mr. Halliday wanted to know what could be done about free riders. I noted that this is less of a problem now that countries are more willing to risk litigation and the banks are more willing to break up the cartelized structure of the restructuring agreements. I did not see ways for the tax and regulatory authorities to do much about the free rider problem.

cc. Messrs. Qureshi (OPNSV); Kashiwaya (CFSVP); Karaosmanoglu (ASIVP); S. Husain (LACVP); Jaycox (AFRVP); Wapenhans (EMNVP); Stern (FINSV); Wood (FPRVP); Shihata (LEGVP); Thalwitz (PPRSV); Fischer (DECVP); Shakow (SPRDR); Dubey (EAS); Shilling, Flannery, Toft (CFSFA).

DBock:ya

OFFICE MEMORANDUM

DATE: April 7, 1990

TO: Files

FROM: David Bock 

EXTENSION: 72942

SUBJECT: Meeting with Mr. Shiratori re Review of Brady Initiative

1. Mr. Kashiwaya and I met with Mr. Shiratori on April 4 to discuss the review of the program on debt and debt service reduction. Mr. Shiratori said he felt the general tone of the paper was a bit too sympathetic to the debtor countries, rather than stressing the fundamental role of their own actions to solve the debt problem. Also, he at least was not at all surprised by the lack of new money over the past year, and did not think that such an issue should have been made of that outcome.

2. Mr. Shiratori also indicated four specific areas where he probably could not support the paper's recommendations. First, he did not think the Bank should "give advice" in the negotiations. By this, he meant telling the banks how to structure and price the menu of options. We replied that that was not the intention, rather to make clear at the outset what we saw as the financing requirements for the country concerned and the importance that we attach to having adequate and appropriate financing packages. Also, we would need to let banks and borrowers know whether we thought tentative proposals were likely to prove acceptable, since Board approval of DDSR support is in all cases based on the specifics of the deal as well as its likely result.

3. Second, Mr. Shiratori did not agree that the Bank should make DDSR support available where arrears were not being cleared/avoided. We responded that this was not our intention, although we could see how the paper might be read that way. Third, Mr. Shiratori remained skeptical of our ability to get banks to provide contingencies. We responded that contingency financing was not the only consideration. Our central point was that transactions needed to take into account downside risks as well as upside potential, otherwise the debt structure resulting from the transactions supported by the Bank would not be sustainable over the longer term. We agreed that it would continue to prove difficult to obtain contingency financing from the banks, especially as the majority were now intent on exiting rather than providing new money.

4. Fourth, Mr. Shiratori was not in favor of fungibility as a general policy. He feels that this will lead to use of the interest support funds for buybacks, something that he sees as bailing out the banks with official money. He thinks this can be dealt with once we see a case that genuinely cannot be done without it. He might be able to support the formulation contained in the paper.

5. Finally, Mr. Shiratori would like to see other countries provide bilateral funds for DDSR. Japan remains reluctant to frontload its parallel lending in conjunction with DDSR support by the Bank and the Fund.

cc. Messrs. Qureshi (OPNSV); Kashiwaya (CFSVP); Karaosmanoglu (ASIVP); S. Husain (LACVP); Jaycox (AFRVP); Wapenhans (EMNVP); Stern (FINSV); Wood (FPRVP); Shihata (LEGVP); Thalwitz (PPRSV); Fischer (DECVP); Shakow (SPRDR); Dubey (EAS); Shilling, Flannery, Toft (CFSFA).

DBoek:ya

OFFICE MEMORANDUM

DATE: April 6, 1990

TO: Files

FROM: Erik F. Nielsen 

EXTENSION: 73363

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CONFIDENTIAL

OCT 30 2023

WBG ARCHIVES

SUBJECT: Meetings with EDs on Brady Initiative Review Paper; Mr. Benachenhou

1. Messrs. Bock, Shilling, and I met this afternoon with Mr. Benachenhou and Mr. Kabbaj, Alternate in the Fund, to discuss their preliminary views on the Board paper review of the Brady Initiative.
2. Mr. Benachenhou inquired about the recommendations concerning the role of the Bank. In particular, he was worried that if a greater role in the negotiations was agreed upon, the Bank might end up "on the banks' side", not on the countries'. Mr. Kabbaj added that the countries need the Bank to emphasize the need for, for example, downside contingencies. Mr. Bock agreed and noted that the Bank should make clear what the parameters for Bank participation are. Mr. Shilling added that while the report does not suggest that the Bank should become part to the negotiations, it should not be taken for granted either. Mr. Benachenhou agreed.
3. Mr. Benachenhou thought that front loading would be necessary also in the future. Mr. Bock explained our position. Mr. Benachenhou appeared satisfied when assured that front loading could be approved on a case-by-case basis.
4. Mr. Benachenhou inquired about which countries were anticipated to be next in line. Mr. Shilling mentioned a number of likely candidates, and Mr. Benachenhou noted with satisfaction that staff is pushing the program forward.

Cleared with & cc: Mr. Bock

cc: Messrs. Qureshi (OPNSV); Kashiwaya (CFSVP); Karaosmanoglu (ASIVP); S. Husain (LACVP); Jaycox (AFRVP); Wapenhans (EMNVP); Stern (FINSV); Wood (FPRVP); Shihata (LEGVP); Thalwitz (PPRSV); Fischer (DECVP); Shakow (SPRDR); Dubey (EAS); Shilling, Flannery, Toft (CFSFA)

ENielsen:gm

OFFICE MEMORANDUM

DATE: April 6, 1990

TO: Files

FROM: Erik F. Nielsen

EXTENSION: 73363

DECLASSIFIED

CONFIDENTIAL

OCT 30 2023

WBG ARCHIVES

SUBJECT: Meetings with EDs on Brady Initiative Review Paper; Mr. Haralz

1. Messrs. Bock, Shilling, and I met this afternoon with Mr. Haralz, ED for the Nordic countries, and his assistant, Mr. Henriksson, to discuss their preliminary views on the Board paper review of the Brady Initiative.
2. Mr. Haralz commenced by saying that both his authorities and the Nordic authorities for the Fund would focus on the strength of the program. He was not clear if the paper suggested a change in this respect. Mr. Bock noted that this paper did not intend to indicate a fundamentally new approach, only a strengthened version of what had already been followed. Mr. Shilling added that while the Bank should not stop supporting a successful adjustment program, it should certainly not finance aggressive arrears.
3. Mr. Henriksson wondered if the signal in the paper was the right one to send at this stage. Mr. Bock thought it important to make clear now before the program expanded to a number of countries with less of a track record what the general rules for Bank participation would be. The focus should be on adequate and appropriate financing and, to balance this off, flexibility on fungibility and front loading.
4. Mr. Haralz supported fungibility as recommended in the paper. He asked to what extent lack of fungibility had been a problem thus far. Mr. Bock said that, in particular, the Philippines had been constraint in their approach. Mr. Haralz also supported the recommendations concerning waivers and downside contingencies.

Cleared with & cc: Mr. Bock

cc: Messrs. Qureshi (OPNSV); Kashiwaya (CFSVP); Karaosmanoglu (ASIVP); S. Husain (LACVP); Jaycox (AFRVP); Wapenhans (EMNVP); Stern (FINSV); Wood (FPRVP); Shihata (LEGVP); Thalwitz (PPRSV); Fischer (DECVP); Shakow (SPRDR); Dubey (EAS); Shilling, Flannery, Toft (CFSFA)

ENielsen:gm

OFFICE MEMORANDUM

DATE: April 6, 1990

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TO: Files

OCT 30 2023

FROM: Erik F. Nielsen

WBG ARCHIVES

EXTENSION: 73363

SUBJECT: Meetings with EDs on Brady Initiative Review Paper; Mr. Al-Sultan

1. Messrs. Bock, Shilling, and I met this afternoon with Mr. Al-Sultan, ED for Kuwait et al, and his Advisor, Mr. Faruqi, to discuss their preliminary views on the Board paper review of the Brady Initiative.
2. Mr. Al-Sultan thought it was a very good paper and he saw no problems in supporting its recommendations. He only had a number of clarifying points to raise.
3. Mr. Al-Sultan thought the Bank has resources to play a larger role in the negotiations. Mr. Bock recalled that the Board last year had given clear instructions to stay out of the negotiations. This had caused some constraint, now he thought it important to re-emphasize to the parties concerned that the Bank has high standard for its support of DDSR transactions. He did not think it appropriate for the Bank to try to dictate the terms of the agreements. Mr. Al-Sultan agreed. Mr. Faruqi wondered if such emphasis would make negotiations more difficult in the future. Mr. Bock thought DDSR would become increasingly difficult but this would be due more to the fact that the next countries in line did not have sufficient track records.
4. Mr. Al-Sultan inquired about the discussion of front loading. Mr. Bock explained that after the three agreements thus far, it seemed appropriate to remind the parties that phased disbursement is the rule, not front loading. But flexibility in the application was still recommended.
5. Mr. Faruqi was worried that increased fungibility would strengthen the hands of the banks rather than of countries. Mr. Bock said that the banks had used the Bank's rigidities as excuses for not providing good deals. This recommendation was in order to make the Bank more flexible. Mr. Al-Sultan agreed.
6. Mr. Faruqi asked if free riding could be prevented by tax and regulatory changes. Mr. Shilling responded that some changes had taken place, but it was difficult to imagine that such changes could solve the problem.

Cleared with & cc: Mr. Bock

cc: Messrs. Qureshi (OPNSV); Kashiwaya (CFSVP); Karaosmanoglu (ASIVP); S. Husain (LACVP); Jaycox (AFRVP); Wapenhans (EMNVP); Stern (FINSV); Wood (FPRVP); Shihata (LEGVP); Thalwitz (PPRSV); Fischer (DECVP); Shakow (SPRDR); Dubey (EAS); Shilling, Flannery, Toft (CFSFA)

OFFICE MEMORANDUM

DATE: April 6, 1990

TO: Files

FROM: Erik F. Nielsen 

EXTENSION: 73363

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OCT 30 2023

WBG ARCHIVES

SUBJECT: Meetings with EDs on Brady Initiative Review Paper; Mr. Wiesner

1. Messrs. Bock, Shilling, and I met this afternoon with Mr. Wiesner and his Alternate, Mr. Malan, to discuss their preliminary views on the Board paper review of the Brady Initiative.
2. Mr. Wiesner noted that the target of DDSR operations is to reach a sustainable situation. In order to achieve this, the IFIs would need to state up front what the discount should be for the IFIs to support the agreements. Mr. Malan added that deep discounts were needed to reduce the transfer risk to the IFIs. Mr. Bock responded that for a group of countries, e.g. Costa Rica, voluntary discounts provided sufficient relief, but for a number of larger countries there was a resource constraint. Therefore, the Bank should emphasize the need for adequate and appropriate financing, but he thought it important to leave the modalities to be decided by the negotiating parties. Mr. Wiesner partly agreed, but he did not think it right to take the discounts and lack of new money for granted.
3. Mr. Wiesner also commented on the burden sharing. Mr. Shilling noted that quantifying burden sharing in the traditional sense only works when creditors have some what similar objectives. Indeed, it does not work when one group wants to exit.

Cleared with & cc: Mr. Bock

cc: Messrs. Qureshi (OPNSV); Kashiwaya (CFSVP); Karaosmanoglu (ASIVP); S. Husain (LACVP); Jaycox (AFRVP); Wapenhans (EMNVP); Stern (FINSV); Wood (FPRVP); Shihata (LEGVP); Thalwitz (PPRSV); Fischer (DECVP); Shakow (SPRDR); Dubey (EAS); Shilling, Flannery, Toft (CFSFA)

ENielsen:gm

OFFICE MEMORANDUM

DATE: April 6, 1990

TO: Files

FROM: Erik F. Nielsen 

EXTENSION: 73363

SUBJECT: Meetings with EDs on Brady Initiative Review Paper; Mr. Morales

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OCT 30 2023

WBG ARCHIVES

1. Mr. Bock and I met this morning with Mr. Morales ED for Argentina et al, to discuss his preliminary views on the Board paper review of the Brady Initiative.
2. Mr. Morales wondered if the past experience with the U.S. Treasury playing an important intermediate role in the negotiations was the best way to achieve satisfactory results for the debtors. He would like to see the IFIs step in and take a more central role in order to help push down secondary market prices. Mr. Bock noted that the objective of this exercise was somewhat more modest. He added that, while he did not favor the Bank dictate the terms of the agreements, he thought it important to make explicit up front what the parameters for Bank participation should be. The Bank should not be taken for granted. Mr. Morales agreed with that.
3. Mr. Morales noted that it was clear by now that the banks wanted to exit. It was important that this did not happen on the expense of the IFIs. With the commercial banks getting out, there would not be enough money for development. Mr. Bock agreed that it was now a stage of debt settlement instead of new money and some debt reduction, therefore it was important to ensure adequate financing in connection with DDSR operations. On the latter point, Mr. Bock noted that the domestic savings had to make up for the shortfall caused by external sources. In addition, if policy encouraged domestic savings, direct foreign investment would increase, bringing ECAs and commercial banks for specific purpose financing.

Cleared with & cc: Mr. Bock

cc: Messrs. Qureshi (OPNSV); Kashiwaya (CFSVP); Karaosmanoglu (ASIVP); S. Husain (LACVP); Jaycox (AFRVP); Wapenhans (EMNVP); Stern (FINSV); Wood (FPRVP); Shihata (LEGVP); Thalwitz (PPRSV); Fischer (DECVP); Shakow (SPRDR); Dubey (EAS); Shilling, Flannery, Toft (CFSFA)

ENielsen:gm

OFFICE MEMORANDUM

DATE: April 6, 1990

CONFIDENTIAL

TO: Files

FROM: Erik F. Nielsen 

EXTENSION: 73363

DECLASSIFIED

OCT 30 2023

WBG ARCHIVES

SUBJECT: Meetings with EDs on Brady Initiative Review Paper; Mr. Potter

1. Mr. Bock and I met this morning with Mr. Potter, ED for Canada et al, and his advisor, Mr. Sevigny, to discuss their preliminary views on the Board paper review of the Brady Initiative.
2. Mr. Potter thought the paper presented a very sensible approach to the issues at this stage. He expressed his great surprise of what he understood was reservations to the paper's recommendations from the U.S. authorities.
3. On specifics, Mr. Potter inquired about the likely role of the Bank in the negotiations compared with the present situation. Mr. Bock referred to paragraph 68 in the paper and said that the paper suggest that management at an early stage of negotiations is able to indicate what the general parameters are for the Bank to participate in the financing of a package. Mr. Potter agreed with this interpretation. In addition, Mr. Potter noted that he supports the recommendation to make set asides and additional funds fungible.
4. Mr. Sevigny asked about the materiality criteria, he wanted to be sure that interpretations like in the case of Chile not be repeated. An emphasis on big deals would cause a bias against smaller countries. In addition, he noted that rate of return calculations were more tangible whereas the indirect effects were difficult to estimate and therefore should not be made the heart of the justification for bank support. For example in Mexico the major part of the benefits had come through return of flight capital and increased foreign direct investments, and such effects could not be estimated reliably. Mr. Bock agreed and referred to footnote 23 and paragraph 79; the criteria should not be seen as roadblock for small deals. Mr. Bock also noted that support for DDSR was normally part of IBRD adjustment lending which itself had to satisfy materiality criteria under the exceptional circumstances provision of the Articles. If this condition is met, and if the resources released through DDSR are not used for unproductive purposes, these DDSR transactions should not produce insurmountable difficulties. The important thing is that DDSR support be part of a program of adjustment and financing for which Bank support is essential.
5. Mr. Sevigny also commented on the burden sharing issue which he thought difficult to apply in a quantitative way when creditors had different strategies. He thus concurred with the report. Eventually, he

speculated about the different terms for Bank and Fund loans for DDSR, he was somewhat worried about the fact that Fund loans are so much shorter than Bank loans when applied to same transactions.

Cleared with & cc: Mr. Bock

cc: Messrs. Qureshi (OPNSV); Kashiwaya (CFSVP); Karaosmanoglu (ASIVP); S. Husain (LACVP); Jaycox (AFRVP); Wapenhans (EMNVP); Stern (FINSV); Wood (FPRVP); Shihata (LEGVP); Thalwitz (PPRSV); Fischer (DECVP); Shakow (SPRDR); Dubey (EAS); Shilling, Flannery, Toft (CFSFA)

ENielsen:gm

OFFICE MEMORANDUM

DATE: April 6, 1990

TO: Files

FROM: Erik F. Nielsen

EXTENSION: 73363

SUBJECT: Meetings with EDs on Brady Initiative Review Paper; Mr. Zhang

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OCT 30 2023

WBG ARCHIVES

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1. Mr. Bock and I met this morning with Mr. Zhang, ED for China, to discuss his preliminary views on the Board paper review of the Brady Initiative.
2. Mr. Zhang agreed with the paper's approach toward increasing the flexibility, but this should be kept within financial prudence. Mr. Bock noted the limited objective of the present exercise, the idea was not to change the strategy but simply to clarify the parameters for Bank participation in DDSR operations.
3. Mr. Zhang expressed concern about the lack of new money. He thought that this might threaten the entire strategy. Mr. Bock explained that in the context of the present paper this issue is subsumed under the need for adequate and appropriate financing packages (i.e. new money and DDSR are different modalities for filling financing gaps). He also noted that the decline in new money availability increases the need for sustained, effective adjustment by the countries concerned.

Cleared with & cc: Mr. Bock

cc: Messrs. Qureshi (OPNSV); Kashiwaya (CFSVP); Karaosmanoglu (ASIVP); S. Husain (LACVP); Jaycox (AFRVP); Wapenhans (EMNVP); Stern (FINSV); Wood (FPRVP); Shihata (LEGVP); Thalwitz (PPRSV); Fischer (DECVP); Shakow (SPRDR); Dubey (EAS); Shilling, Flannery, Toft (CFSFA)

ENielsen:gm

WORLD BANK, INTERNATIONAL FINANCE CORPORATION, MIGA
OFFICE MEMORANDUM

Date: April 3, 1990
To: Files
From: John D. Shilling, Manager, CFSFA
Extension: 72773
Subject: Discussion of Debt Paper with US

I attended a lunch today, hosted by Mr. Dawson, US ED to the IMF, and attended by Messrs Coady (WB ED), Fall (US Treasury), Ms Chavez (US Treasury), Messrs Leddy and Watson (IMF). The purpose was to continue previous discussions of the Bank and Fund debt papers and the joint paper and (Bank) President's Report to the Development Committee. The atmosphere was congenial, and most of the material covered was a rehash of what was covered at the higher level meeting last week. The US is still clearly concerned that the papers will be interpreted as criticism of the Brady Initiative and that there not be any modification in the guidelines to increase the extent of IFI intervention in the negotiations or to allow more fungibility.

It was clear that the US felt it should have been allowed to comment on (and reshape?) the papers before they were presented. Mr. Leddy pointed out that there had been discussions by the MD and other senior staff of both institutions with a number of interested officials as well as a number of Board discussions that were reflected in both the Board papers, and their content wasn't out of line with those discussions. Mr. Dawson noted that, nevertheless, Messrs Mulford and Delarra were not pleased and that the views of Directors did not always reflect those of G-7 Ministers.

On specific issues, the Treasury felt that the paper seemed overly concerned about the implied inflexibility of bearer bonds (which could be reduced if some additional covenants were added), that there was an apparent overemphasis on buybacks and step-down step-up bonds in relation to the Mexico type instruments, and that any modification in the guidelines on fungibility might upset a delicate balance and open up the door to many other changes in the guidelines. The response of the Fund staff and myself was that the papers were supportive of the strategy, raised well known issues for consideration in a responsible, but did not want to make fundamental changes. Rather, they would open up the strategy to more options and be sure that the IFIs were not faced with unacceptable deals, or uncomfortable situations, such as too much front loading.

In the course of the discussion, it became clear the Treasury believed that Mexico type bonds achieved greater overall debt relief than buybacks or step-down bonds for a given amount of enhancement and given secondary market price. We noted that our analysis showed that in the deals so far, any differences were second order. It was suggested that there be some further technical discussions to clarify this issue.

Treasury was also concerned about the statements in the Development Committee papers implying (rather more clearly in the President's report) that there needed to be major changes in the strategy for official debt, including debt reduction. In the discussion, it was clear their primary concern was about tactics, timing, and presentation. Mr. Dawson recognized that Egypt may well force the issue in the near future, and the rule had already been stretched in Poland. He emphasized that the US was not yet ready to discuss the problem in public and did not want it raised at this time.

cc: Qureshi, Stern, Kashiwaya, Bock, Nielsen, Haug, Leddy (IMF),
Watson (IMF)

OFFICE MEMORANDUM

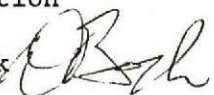
900329006

see Mr. Dubey

DATE: March 29, 1990

CONFIDENTIAL

TO: See Distribution

FROM: David R. Bock 

EXTENSION: 72942

DECLASSIFIED

OCT 30 2023

WBG ARCHIVES

SUBJECT: Meeting with U.S. Treasury on the Brady Progress Review

1. Messrs. Stern, Karaosmanoglu and I met yesterday with Mr. Dallara and his colleagues at the Treasury. The meeting was called by the Treasury and was also attended by Messrs. Erb, Whittome, Leddy and Watson from the Fund, as well as Messrs. Coady and Dawson. The tone of the meeting was informal, friendly and constructive.

2. The purpose of the meeting was to discuss the recent set of Board papers related to the debt strategy (i.e. the President's Report, the Bank-Fund background paper, the Bank's progress review and the Fund's debt strategy paper). The discussion covered a number of topics but two points seemed to be of particular concern: first, Treasury staff are upset at the lack of prior consultation on "proposals" for official debt; second, they have serious reservations about a more pro-active role for the Bank and the Fund in commercial bank debt negotiations.

3. On the first point, Treasury staff drew particular attention to the statement in the President's Report about the absence of a coherent strategy for official debt (para. 37), which they believe is also contained in the Fund debt paper albeit in a less direct way. Mr. Dallara asked pointedly why there had been no consultation with the US or other creditor governments prior to release of these papers on the specific proposals for extension of Toronto terms to countries outside of Africa, increased concessionality for low income countries, and concessional debt relief for the middle income countries.

4. In responding to the point on official debt, it was noted that Paris Club has already agreed to Toronto terms for Bolivia and that the need for more fundamental measures with respect to official debt is not a particularly new theme in either the Fund or the Bank. Mr. Erb pointed out that Fund management had agreed to go ahead with the program for Poland on the explicit understanding that the Paris Club would address the Polish debt situation in a more fundamental way. The same issues have come up in Mozambique and will be faced in Egypt and Cote d'Ivoire if programs are agreed and kept on track. The Fund is pulled in different directions by its stockholders who criticize extended use of Fund resources yet do not deal effectively with the overhang of official debt.

5. In the end, it was acknowledged that some prior consultation would have been appropriate; it was also agreed that it would be useful in the future to have more formal consultations with the Paris Club on such

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WBG ARCHIVES

Meeting with U.S. Treasury on the Brady Program Review

Mr. Robert Storn, Assistant Secretary for International Finance and Development, U.S. Treasury, and his colleagues at the Treasury, the meeting was held in the Treasury Department, Washington, D.C., on October 1, 1992. The meeting was held in the Treasury Department, Washington, D.C., on October 1, 1992. The meeting was held in the Treasury Department, Washington, D.C., on October 1, 1992.

The purpose of the meeting was to discuss the progress of the Brady Program Review. The meeting was held in the Treasury Department, Washington, D.C., on October 1, 1992. The meeting was held in the Treasury Department, Washington, D.C., on October 1, 1992. The meeting was held in the Treasury Department, Washington, D.C., on October 1, 1992.

On the first day of the meeting, Mr. Storn presented a statement to the group. The statement was presented to the group. The statement was presented to the group. The statement was presented to the group. The statement was presented to the group.

The group then discussed the statement. The group then discussed the statement. The group then discussed the statement. The group then discussed the statement. The group then discussed the statement. The group then discussed the statement. The group then discussed the statement. The group then discussed the statement. The group then discussed the statement.

The meeting concluded with a summary of the discussion. The meeting concluded with a summary of the discussion. The meeting concluded with a summary of the discussion. The meeting concluded with a summary of the discussion. The meeting concluded with a summary of the discussion.

policy issues. Related to this, it appears that Mr. Trichet was also upset about references to the Paris Club terms/approach. Mr. Samuel-Lajeunesse will be in Washington today and may be taking this issue up directly with the Fund and Bank managements.

6. On commercial bank negotiations, Treasury staff criticized the papers as being unbalanced and failing to give adequate recognition to what had been achieved. They seemed most concerned about the suggestion that the Fund and the Bank would get more directly involved in the negotiations, perhaps imposing restraints on the terms of transactions, seeking to shape the modalities of debt and debt service reduction and/or intervening to get the financing gap closed. Treasury expressed strong reservation about such intervention. Mr. Dallara reiterated the Treasury's view that the "strengthened debt strategy" involves a change in the gap process, and a need on the part of the official institutions to live with more uncertainty and financing risk. He argued that the previous approach produced a false sense of comfort about financing packages and that the new approach could not be launched without the official institutions adopting a different approach on financing assurances. Also, the fact that the programs are tight and somewhat inflexible is putting additional pressure on the countries to adjust and manage in a more disciplined fashion.

7. Both Messrs. Stern and Erb stressed that the key issue is how to strike the right balance between the old critical mass approach and the completely hands-off acceptance of whatever financing could be raised on a voluntary basis. In our view, the pendulum has swung too far away from a disciplined and pre-agreed financing plan based on fair burden sharing of all parties. Instead, the commercial banks take the amount of Bank and Fund financing as a given and expect the two institutions to support whatever package they have negotiated with the countries concerned. We do not regard a hands-off approach as acceptable but acknowledge that the degree of intervention required is a matter of judgment. No hard and fast rule can be laid down, and the Bank's paper, at least, does not propose major change in the guidelines in this regard, simply a strengthening and reaffirmation that an appropriate balance has to be struck on a case by case basis.

8. The meeting concluded with an agreement that (a) Treasury staff would follow up on specific points with respect to the forthcoming Board discussions and (b) more regular meetings of yesterday's type would be held in the future.

Distribution:

Messrs. Conable, Qureshi, Stern, Karaosmanoglu, Kashiwaya, Thalwitz, Fischer, Shihata, Wood, Thahane, Shakow

cc: Ms. Haug, Mr. Shilling

cc: Mr. Watson (IMF)

OCT 30 2023

WBG ARCHIVES

THE WORLD BANK / IFC / MIGA

OFFICE MEMORANDUM

DATE: March 29, 1990

CONFIDENTIAL

TO: Files

FROM: Erik F. Nielsen, CFSFA

EXTENSION: 73363

SUBJECT: Meetings with EDs on Brady Initiative Review Paper; Mr. Landau

1. Mr. Bock and I met this afternoon at 4:30 with the French ED, Mr. Landau, and Mr. Samuel-Lajeunesse who reportedly was in Washington for regular meetings with the US Treasury.

2. Mr. Samuel-Lajeunesse concluded that he had no problems with the recommendations in the review paper of the Brady Initiative. In particular, he appreciated the recommendations of a phased approach connected with the discussion of new and temporary relief instruments. In addition, it was important to emphasize the case-by-case approach because, while he shared the raised concerns with respect to comprehensive deals, such agreements could have substantial impact on the return of flight capital. If any difference in nuance, he would lean toward more, rather than less, Bank and Fund participation in negotiations.

3. Mr. Landau inquired about the recommendation of increased fungibility. Mr. Bock used the example of the Philippines, where this criteria had limited the benefits for the borrower. Concerning the role of the Bank in the negotiations, Mr. Bock said that the intention was to re-affirm the role the Bank had played thus far. In particular, he thought it important that the Bank up front makes known to the participants the parameters for Bank approval of funding; the Bank should not go further than that, and should indeed not try to dictate the discounts. Messrs. Samuel-Lajeunesse and Landau agreed with that.

4. Mr. Bock continued to explain the phased approach recommendation in the paper. The "big bang" approach in the case of Mexico was not generally beneficial. A temporary interest reduction would be appropriate in some cases of liquidity constraints, and in addition one could build on a gradual reduction in stocks as well. The purpose of this part of the paper was to respond to the push from the private creditors toward the official lenders in the case of, for example, Mexico.

5. Mr. Samuel-Lajeunesse said that, despite the fact that the President's report was not Mr. Bock's responsibility, he wished to express his great surprise when he had read in that report that there is no strategy for the official debt to the LDCs. Such a statement was, apart from being untrue, an aggression against the Bank's shareholders. Not only the French, but also the Japanese and others were very upset about such a tone in that paper. He deeply regretted that there had been no prior consultations with the authorities before the report had been formulated. Mr. Landau added that this approach would prove counterproductive. Mr. Bock thought it preferable if the matter be discussed with the authors, Messrs. Shakow and Carter.

6. The discussion then briefly turned to IDA. Mr. Samuel-Lajeunesse thought the US\$100 million was too small an amount; it ought to be US\$100 million each year. The funds should be used only when deep discounts could be achieved, but this did not mean that the Bank or the Tresor should suggest to Senegal and the like not to pay the banks in order to drive down secondary market prices. Mr. Bock suggested that Mr. Samuel-Lajeunesse bring the former point-of-view to the attention of Mr. Stern; he agreed with the latter statement.

7. Mr. Landau pointed out that the Bank and the Fund soon will be the only lenders to LDCs who charge market rate. Mr. Bock responded that for the Bank it is a blend issue. By not rescheduling, but changing the blend toward softer terms, the Bank provided a contribution to the burden sharing without impairing its own standing.

Cleared with & cc: Mr. Bock

cc: Messrs. Qureshi (OPNSV); Kashiwaya CFSVP); Karaosmanoglu (ASIVP);
S. Husain (LACVP); Jaycox (AFRVP); Wapenhans (EMNVP);
Stern (FINSV); Wood (FPRVP); Shihata (LEGVP);
Thalwitz (PPRSV); Fischer (DECVP); Shakow (SPRDR);
Dubey (EAS); Shilling, Flannery, Toft (CFSFA)

Nielsen:gm

OFFICE MEMORANDUM

DATE: March 30, 1990

TO: Files

FROM: Erik F. Nielsen, CFSFA

EXTENSION: 73363

SUBJECT: Meetings with EDs on Brady Initiative Review Paper; Mr. Baijal

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OCT 30 2023

WBG ARCHIVES

1. Mr. Bock and I met this afternoon at 12:30 with Mr. Baijal, ED for India et al, and his advisor to discuss their preliminary views on the Board paper review of the Brady Initiative.

2. Mr. Baijal expressed doubt that the program in the first place works, and he was not convinced that the recommended changes would fix this problem. Thus, if debt stocks were reduced by 40%, balance of payments scenarios would still not be viable. Mr. Bock responded that he thought the program had worked reasonably well thus far, but at any account, the purpose of this exercise was not to change the strategy, merely to "fire a warning shot over the battle field" to make sure the participants did not take the Bank's contribution for granted. Concerning the hypothetical 40% debt stock reduction, Mr. Bock pointed to the effect of a drastic reduction in negative net transfers and the accompanied macroeconomic adjustment, all leading to increased confidence and return of flight capital.

3. Concerning the role of the Bank, Mr. Baijal wondered what management could contribute to the deals if staff were to participate in the negotiations. He doubted that agreements would be better for the debtors, and he definitely thought that the Bank's participation would be creditworthy only after it had said no to a proposed deal. Mr. Bock said that the ambition was not so much to improve the deals, but rather to prevent them from deteriorating. Concerning the "no" impact, he agreed and drew the attention to the drastic implications such a no would have for a country's entire economic team; precisely therefore, he thought, was it extra important to make clear up front what the parameters for Bank participation would be.

4. Mr. Baijal's advisor interpreted the paper's lack of discussion of the financial effects of the Mexico package as an indication of "second thoughts". Mr. Bock drew the attention to the fact that this had been dealt with so recently in the Board paper for the approval of the transaction, and there appeared no need to repeat that assessment.

Cleared with & cc: Mr. Bock

cc: Messrs. Qureshi (OPNSV); Kashiwaya (CFSVP); Karaosmanoglu (ASIVP); S. Husain (LACVP); Jaycox (AFRVP); Wapenhans (EMNVP); Stern (FINSV); Wood (FPRVP); Shihata (LEGVP); Thalwitz (PPRSV); Fischer (DECVP); Shakow (SPRDR); Dubey (EAS); Shilling, Flannery, Toft (CFSFA)

ENielsen:gm

OFFICE MEMORANDUM

DATE: March 30, 1990

CONFIDENTIAL

TO: Files

DECLASSIFIED

FROM: Erik F. Nielsen, CFSFA

OCT 30 2023

EXTENSION: 73363

WBG ARCHIVES

SUBJECT: Meetings with EDs on Brady Initiative Review Paper: Mr. Aunsnunta

1. Messrs. Bock, Toft, and I met this morning at 11:00 with Mr. Aunsnunta, ED for Thailand et al, to discuss his preliminary views on the Board paper review of the Brady Initiative.

2. In general, Mr. Aunsnunta thought that present guidelines were appropriate and that only minor changes were needed. He thus agreed with the main thrust of the paper; the main purpose of this exercise was to increase management's flexibility. Specifically, though, he predicted that the Board would be hesitant to approve the recommended flexibility concerning fungibility.

3. He inquired about the potential activation of the ECO program. He noted that a number of countries in his constituency were not candidates for DDSR, and therefore anticipated ECO. Mr. Bock agreed that ECO would play a role in some of these countries, but the process had proven more time consuming than originally anticipated.

Cleared with & cc: Mr. Bock

cc: Messrs. Qureshi (OPNSV); Kashiwaya (CFSVP); Karaosmanoglu (ASIVP); S. Husain (LACVP); Jaycox (AFRVP); Wapenhans (EMNVP); Stern (FINSV); Wood (FPRVP); Shihata (LEGVP); Thalwitz (PPRSV); Fischer (DECVP); Shakow (SPRDR); Dubey (EAS); Shilling, Flannery, Toft (CFSFA)

ENielsen:gm

OFFICE MEMORANDUM

DATE: March 30, 1990

TO: Files

FROM: Erik F. Nielsen, CFSFA

EXTENSION: 73363

SUBJECT: Meetings with EDs on Brady Initiative Review Paper; Mr. Boehmer

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OCT 30 2023

WBG ARCHIVES

1. Mr. Bock and I met this morning at 10:00 with the German ED, Mr. Boehmer, and his alternate, Mr. Esdar, to discuss their preliminary views on the Board paper review of the Brady Initiative.
2. Mr. Boehmer thought the paper was "precise, concise, and interesting to read". In this light, he noted that the joint Bank-Fund paper to the Developing Committee was surprisingly vague.
3. On specifics, Mr. Boehmer asked about the recommendations on fungibility and contingencies. Mr. Bock explained the rationale behind the paper's recommendations. Mr. Esdar noted that these recommendations were in line with their thinking, but there might be some diverting point-of-view on fungibility in Bonn. He was to leave for Germany tonight to consult with the authorities on reactions to the paper, and he believed he would be able to convince his authorities about the sensibility of increased flexibility on this issue.

Cleared with & cc: Mr. Bock

cc: Messrs. Qureshi(o/r) (OPNSV); Kashiwaya (CFSVP); Karaosmanoglu (ASIVP); S. Husain (LACVP); Jaycox (AFRVP); Wapenhans (EMNVP); Stern (FINSV); Wood (FPRVP); Shihata (LEGVP); Thalwitz (PPRSV); Fischer (DECVP); Shakow (SPRDR); Dubey (EAS); Shilling, Flannery, Toft (CFSFA)

ENielsen:gm

OFFICE MEMORANDUM

DATE: March 30, 1990

TO: Files

FROM: Erik F. Nielsen, CFSFA

EXTENSION: 73363

SUBJECT: Meetings with EDs on Brady Initiative Review; Mr. Al-Assaf

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OCT 30 2023

WBG ARCHIVES

1. Mr. Bock and I met this morning at 9:30 with Mr. Al-Assaf, ED for Saudi Arabia, and his staff to discuss his preliminary views on the Board paper review of the Brady Initiative.

2. Mr. Al-Assaf thought it was a good and frank paper. In general, he expressed concern about the effects of the program. Thus, the Mexico package had been reached only after a lot of political pressure and still its impact was not impressive. In this light, were we regretting our commitment to the voluntary approach? Mr. Bock responded that this is not the final stage, but an important new stage. And for some countries, e.g. Costa Rica, the program was sufficient. In addition, this paper did not intend to revise the general strategy.

3. On specifics, Mr. Al-Assaf inquired about the proposals concerning fungibility, the role of the Bank, and waivers. Mr. Bock explained the background for the proposals, and Mr. Al-Assaf agreed with them being sensible. On fungibility, Mr. Al-Assaf's advisor thought the ambiguity in the existing guidelines had been lost in this paper. Mr. Bock explained that if this was the case, it was not intentional. The idea was to increase the flexibility. Mr. Al-Assaf thought creditor countries could do more in terms of the regulatory environment to facilitate DDSR. Mr. Bock was not convinced about this, and he pointed to the substantial bending of rules which had already taken place to accommodate the Mexico package.

4. Mr. Al-Assaf's advisor thought the suggestion of lending in the face of arrears was an important one. He thought more analysis was needed on the implications of such policies, including debtors and creditors behavior in such circumstances. Mr. Bock explained that such lending already took place when the program otherwise was on track. Furthermore, it was an issue more for the Fund, who is discussing the issue in more detail in their paper. Eventually, he asked about the potential use of the ECO. Mr. Bock said that ECO would have a role to play in the future, but only after the banks have settled the issue of debt; indeed, the ECO should not be introduced to finance interest payments to private creditors.

Cleared with & cc: Mr. Bock

cc: Messrs. Qureshi (OPNSV); Kashiwaya (CFSVP); Karaosmanoglu (ASIVP); S. Husain (LACVP); Jaycox (AFRVP); Wapenhans (EMNVP); Stern (FINSV); Wood (FPRVP); Shihata (LEGVP); Thalwitz (PPRSV); Fischer (DECVP); Shakow (SPRDR); Dubey (EAS); Shilling, Flannery, Toft (CFSFA)

ENielsen:gm

OFFICE MEMORANDUM

DATE: March 29, 1990

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CONFIDENTIAL

TO: Files

OCT 30 2023

FROM: Erik F. Nielsen  CFSFA

WBG ARCHIVES

EXTENSION: 73363

SUBJECT: Meetings with EDs on Brady Initiative Review Paper; Mr. Pinto

1. Mr. Bock and I met this afternoon at 2:30 with Mr. Pinto, ED for Mexico et al, to discuss his preliminary views on the Board paper review of the Brady Initiative.

2. Mr. Pinto thought it was a very good and well-balanced paper. In this connection, he wondered about what he thought was a substantial difference in quality between this paper and the joint Bank-Fund paper to the Development Committee; a discussion of the latter paper was not pursued. He pointed out that, in his view, the Brady review paper stroke just the right balance concerning the Bank's involvement in the negotiations. In the past, the Bank had played an appropriate role, and it was important to make explicit that this was the level of involvement that should be continued.

3. Mr. Pinto agreed with the paper's recommendations concerning increased flexibility in the use of the fungibility criteria. If anything, he would lean toward doing away with the two compartments to make the set asides and additional resources generally fungible. In addition, he agreed with the emphasis on the need for downside contingencies. In the case of the Mexico package, this had been desirable, but simply impossible to make the banks to provide such a contingency.

4. Mr. Pinto inquired about the recommendations concerning a more restrictive approach toward front-loading. Mr. Bock explained that the paper recommends a case-by-case approach, the reasons for this is that after the three agreements, all with a considerable degree of front-loading, it appeared appropriate to emphasize that this was not the general rule, but something that needed specific justification in each case. Mr. Pinto agreed with this interpretation.

5. Eventually, Mr. Pinto expressed some concern about the paper's warning against creating inflexible debt. He agreed with the potential danger in the Mexico case, but thought comprehensive deals in certain cases would be justified. If his authorities see this part of the paper as an unjustified criticism of the Mexico package, he would get back in contact with Mr. Bock.

Cleared with & cc: Mr. Bock

cc: Messrs. Qureshi (OPNSV); Kashiwaya (CFSVP); Karaosmanoglu (ASIVP); S. Husain (LACVP); Jaycox (AFRVP); Wapenhans (EMNVP); Stern (FINSV); Wood (FPRVP); Shihata (LEGVP); Thalwitz (PPRSV); Fischer (DECVP); Shakow (SPRDR); Dubey (EAS); Shilling, Flannery, Toft (CFSFA)

ENielsen:gm

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OCT 30 2023

WBG ARCHIVES

World Bank/IFC/MIGA
F I C E M E M O R A N D U M

DATE: 22-Mar-1990 07:14pm

TO: See Distribution Below

FROM: David R. Bock, CFSVP

(DAVID BOCK)

EXT.: 72942

SUBJECT: Meeting with Mr. Coady on Brady Progress Review -CONFIDENTIAL

Jed Shilling and I met this afternoon with Messrs. Coady and Cox at their request. Both had read the Board paper on review of progress under Brady Initiative and had reacted negatively to the tone of the paper. They fear that it will raise major public relations problems because its analysis and presentation can be interpreted as highly critical of the Brady Initiative.

We took strong exception to this interpretation and pressed both Messrs. Coady and Cox as to specifics. After 45 minutes of discussion, Mr. Shilling and I concluded that the problems were mainly presentational not substantive. Messrs. Coady and Cox cited a tendency in the paper to raise issues and concerns that were well known a year ago but which had been successfully dealt with in the initial transactions.

We responded that it is not management's intention to distance itself from the Brady Initiative. To the contrary, the paper conveys a strong sense of ownership of the program. Our objective is to provide a reasonably balanced assessment of the program and to seek the support of the Board for a strong stance with respect to the viability of the DDSR programs that would be supported by the Bank.

Mr. Coady said the Treasury would be reading the paper today. He expected to receive a strong reaction in the morning. In this connection, he cited the problems that the Treasury is presently encountering with our supposed shift of policy away from adjustment lending, which the Treasury interprets as being non-supportive of the debt strategy.

DISTRIBUTION:

TO: Barber B. Conable

(PAPER MAIL)

TO: Moeen A. Qureshi

(MOEEN QURESHI)

TO: Ernest Stern

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TO: Wilfried Thalwitz

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TO: Timothy Thahane

(TIMOTHY THAHANE)

TO: Ibrahim F. I. Shihata

(IBRAHIM F. I. SHIHATA)

TO: Edward V.K. Jaycox

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CC: Koji Kashiwaya

(KOJI KASHIWAYA)

CC: D. Joseph Wood
CC: Stanley Fischer
CC: Hugh Scott
CC: Marianne Haug

(JOE WOOD)
(STANLEY FISCHER)
(HUGH SCOTT)
(MARIANNE HAUG)

OFFICE MEMORANDUM

9003 0600 6

DATE: March 6, 1990

TO: Messrs. Moeen A. Qureshi and Koji Kashiwaya

FROM: David R. Bock *DRB*

EXTENSION: 72942

SUBJECT: Report on Consultations in Tokyo re Brady Initiative

1. Per our discussion, I spent three days in Tokyo consulting with MOF, BOJ, JCIF and leading commercial banks on the experience thus far with the Brady Initiative. A separate note on the discussions with the MOF and BOJ was sent from Tokyo last week (see attached). This memorandum summarizes the results of my discussions with the banks and JCIF.

2. The Brady Initiative has led to a significant shift in the attitudes and strategies of Japanese bankers towards the HICs. This change is still working its way through the system, and may not be fully appreciated by MOF and BOJ. Nonetheless, Japanese banks feel less constrained in their approaches to the debt issue and intend to use their new-found flexibility to reduce exposure via debt exchanges and loan sales. Apart from BOT, the banks will prefer to reduce exposure at a loss rather than lend new money to the majority of the HICs. Brazil may be the one exception, but even here, Japanese banks will be very cautious about new money and will participate only if there is a broad based concerted effort involving, in particular, the US banks. Japanese interest in Venezuela is not very great; new money is likely only if the US banks commit heavily to it.

3. This shift in attitudes has taken place in at least two steps, first with the Mexican package and then with the Philippine package. By and large, the outcome of the Mexican transaction was to shift the Japanese banks into a debt reduction mode. MOF is reported to have orchestrated Japanese banks' participation in the DDSR instruments, apparently in response to the Mexican authorities' initial request. Two reasons were cited for the banks' willingness to uniformly participate in DDSR. First, it will generate substantial tax losses, which the banks are prepared to take in view of strong profits from domestic business plus their extensive hidden reserves. Second, Japanese banks are now trying to reduce their exposure to future new money calls having seen their relative share to the HICs rise during the 80s due to exchange rate effects plus exposure reductions by US banks.

4. In Mexico, the banks took varying combinations of discount and par bonds. A major consideration in their decision making was to reduce their exposure to so called "new money risk", i.e., the risk that they would be asked to provide new money in the future notwithstanding the exit undertaking of the Mexican authorities. Hence, they opted to convert 60-80% of their existing exposure to discount bonds even though the par bond had a higher present value. The minimum share of the par bonds appear to have been 20%, which was dictated by the desire to stabilize interest risk with respect to the Japanese banks' funding base.

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SVPUP

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5. The bridge loan proved to be a substantial irritant also in Japan. The Japanese banks had embraced the Brady Initiative against the background of the original Miyazawa Plan which was developed almost two years ago. Under the Miyazawa Plan, it was understood that official/private burden sharing would involve losses by the banks being offset by increased official resources for credit enhancement. The banks were irritated by the fact that the only bilateral institution to provide additional financing was JExim and that the shortfall in enhancements had to be made up through the bridge loan. Moreover, Japanese banks were unable to get the full amount of their yen exposure converted into bonds due to the much higher costs of yen collateral. Accordingly, they now need to reconvert up to 95% of their exposure back to dollars before swapping into the enhanced instruments.

6. Japanese banks' interest in new money took another beating in the Philippine transaction due to the cheap/free rider problem. The large Japanese banks were told that they could not participate in the buyback due to the size of their exposure and thus dutifully committed to the new money exercise. However, IBJ was allowed to participate in the buyback notwithstanding the fact that its exposure was too large to be completely eliminated. As a result, the other long-term credit banks, trust banks, and insurance companies also participated in the buyback. Of these, it is known that IBJ retained some residual exposure in the Philippines, yet did not contribute to new money with respect to that remaining base debt. Non-Japanese banks' participation was also limited and involved a good deal of cheap, or free, riding. As a result, Japanese banks are now more determined not to be caught again in the position of increasing exposure while others do not. This is further reinforced by the fact that the principal argument for new money that can be used by Japanese banks' management is the need for international cooperation. Failure of the other institutions to do their fair share leads to "embarrassment" for the managements of the new money banks.

7. Some of the banks appear to be puzzled by the lack of MOF intervention in the Philippine package. The general inclination seems to be to interpret this MOF posture as a willingness to allow the banks to pursue institutions' specific strategies with respect to LDC debt. Again, the fact that IBJ was permitted to participate in the buyback is read as a change in policy. Most bankers expect to see far more selling, conversion and trading of LDC debt by Japanese banks over the coming months. None of the banks I spoke to were aware of the background to MOF's behavior in the Philippine deal (i.e., that MOF was unsupportive of the transaction because it involved a cash buyback and no interest reduction instrument).

8. Overall, Japanese banks may be realizing losses equivalent to 15-20% of their HIC portfolio during the fiscal year ending March 31, 1990. Ten percent is due to the increase in the provisioning from 15 to 25%; the balance is due to the losses incurred on the Mexican and Philippine transactions. Most of these losses will be offset by realization of capital gains on equity holdings. As a result of this higher provisioning and a 60% marginal tax rate, the Japanese banks are now in a position to absorb losses of up to 60% of their LDC debt without further impact on their after tax profits.

9. Net losses on the Mexican transaction are as yet undetermined; the Japanese banks will largely opt to mark to market the new bonds which will only receive their initial quotation at the end of this month. Since the fiscal year end quotation is the only one that matters for tax purposes, Japanese banks have some interest in indicating very low grey market prices at this time (which may help explain why the Mexican bonds are trading at such deep discounts in the grey market).

10. Japanese banks' strategies towards international lending are not that dissimilar from those of other nationalities. They have virtually no interest in cross-border lending to Latin America, although they are prepared to do trade finance, some project financing with strong security packages and conversion of a portion of their existing MLT exposure into equity investments in domestic banks (e.g., DKB's recent investment in Unibanco). The Japanese seem to be still willing to expand their operations in Asia, and see major opportunities in the US. In Eastern Europe, Japanese banks are likely to avoid cross-border exposure other than that which is inescapable because of customer interests and which cannot be covered by official guarantees.

11. Other minor points: IBJ appears to be the most determined to reduce exposure to HICs and exit. They are generally critical of their City Bank brethren whom they see as being non-strategic and unimaginative. IBJ rates Philippines as a very bad credit risk and would have happily sold the full Philippine exposure if it had been possible. Banks in general are now much more open about the unique position of Bank of Tokyo, which is by far the most highly exposed Japanese bank in terms of the ratio of LDC loans to total equity, including hidden reserves. Bank of Tokyo, on the other hand, is showing the strains of trying to maintain cohesion in the banking community, especially as banks begin to sense that MOF will no longer provide particularly strong guidance for specific transactions. Banks differ in their view as to whether taking losses necessarily breaks the business relationship with a particular country. Some banks feel that they cannot continue to do any lending once losses have been taken; others make a clear distinction between losses on MLT exposure and continuation of business in trade and project finance.

Attachment

cc: Messrs. Fisher, Shihata, Wood; Husain, Jaycox, Karaosmanoglu,
Wapenhans; Dubey, Goldberg, Linn, Rao; Shakow, Ms. Haug;
Shilling, Flannery, Toft, Nielsen

OFFICE MEMORANDUM

DATE: February 28, 1990

[SENT BY FAX FROM TOKYO]

TO: Mr. Koji Kashiwaya

FROM: David R. Bock

EXTENSION: 72942

SUBJECT: Discussions in Japan

1. I met today with MOF and BoJ re the Brady Initiative. Tomorrow and Friday I will be seeing the banks. I was also asked by BoT to attend the Philippines signing, so I have already seen a number of bankers.
2. On the Philippines, one gets the distinct impression that the deal has left far less bad feeling with the banks than Mexico. Both the former and present Governors (Fernandez and Cuisia) were emphatic about the need for the Philippines to reduce debt in an orderly fashion while maintaining servicing of it. Similarly, Secretary Jayme referred to this commitment as well as unhelpful political elements back home. By separating the terms of DDSR from the process of negotiating waivers, the Philippines has now taken the BAC out of further negotiations on terms; within limits, the Philippines can now do DDSR on terms acceptable to individual banks, and does not need unanimous consent of the BAC. The Central Bank is working on some ideas for DDSR transactions, which they hope to show us in a few weeks.
3. Both MOF and BoJ strike me as much more positive about the Brady Initiative (or at least much less questioning) than other G-7 governments. Brady is seen as stabilizing the political situation in Latin America, giving an impetus to strengthened reforms, and moving us toward an eventual resolution of the problem. Moreover, it was clear that something new was needed; Brady inaugurated a phase of debt settlement and cut the ground out from under the proponents of debt facilities. There will be no more debt "plans". Japanese banks also are reported to be less critical than other banks, in part because they were consulted about the Miyazawa Plan, which is seen as the ancestor of Brady. More explicit three-way burden sharing (LDCs, banks, governments including IFIs) and a stronger commitment to international cooperation are also cited as reasons for the more favorable attitude.
4. Brady is criticized for putting too much emphasis on financing as a solution, rather than better economic management. Nothing will work without better policies and Brady seems weak on that front. Gyoten in particular cited the need for more FDI in areas affecting domestic savings (e.g. the financial sector) and exports.
5. MOF reiterated the set of objections to cash buybacks (moral hazard, elimination of contact with markets, shift of risks to public sector). I pointed out that the banks can cope with the moral hazard by

refusing to sell or grant waivers without IMF programs, current debt service payments, etc. Also, that debt exchanges create moral hazard for creditor governments and IFIs, with future risk shifting heavily to official creditors in the case of Mexico. I sensed some open-mindedness, also some confusion, on this issue. Perhaps one should address MOF's concerns in a technical note. In any event, I did not press these points, as the thrust of MOF's comments were very supportive of temporary rate reductions, which we discussed briefly. Very informally, MOF indicated a willingness to think about use of enhancements for temporary debt service reduction, noting the similarities with the Miyazawa Plan.

6. The Brady Initiative had the effect of "liberating" Japanese banks to pursue their own commercial self-interest in dealing with LDC debt. The systemic pressure to go along with new money deals was fading anyway, Brady officially abolished concerted new money, and in a voluntary market, Japanese banks became sellers and debt reducers. Profits from other businesses are strong this year so banks can realize losses without too much disruption. With the forthcoming rise in provision levels to 25%, plus notional tax losses of an equal amount, Japanese banks' reserving levels will be close to those elsewhere (I don't agree with this point entirely). Unless a borrower is particularly strong, banks will probably opt for DDSR rather than new money. In this connection, BoJ thought the Philippines would have done better if it had asked earlier for new money, before the buyback was implemented. There may be a lesson here for the future. Also, Japanese banks have a strong dislike of free riders and thus welcome some degree of concerted action.

7. BoJ contends that the real test of the Brady Initiative is how quickly countries are restored to creditworthiness and regain access. Perhaps we should think about how the transactions themselves can be structured to achieve that (other than by implausibly deep discounts).

8. Finally, Gyoten pointed out that risk was shifting to the public sector before Brady and will continue to do so. The only questions are in what form and how fast. This would be a worthwhile perspective to include in the Board paper.

cc: Messrs. Qureshi, Kaji, Shilling, Nielsen, Flannery, Toft

DB/mjw



Record Removal Notice

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Subject / Title Bank financing of debt reduction				
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OFFICE MEMORANDUM

DECLASSIFIED

DATE: January 29, 1990

OCT 30 2023 CONFIDENTIAL

TO: See Distribution Below

WBG ARCHIVES

FROM: David R. Bock 

EXTENSION: 72942

SUBJECT: Discussions on the Brady Initiative

1. As we discussed, I have been carrying out a series of consultations on the Brady Initiative with senior level commercial bank executives and G-5 government officials. Although these consultations are not yet complete, I thought it would be useful to share with you some of the key findings at this stage. Most of what follows is based on my discussions in New York, London, Paris and Frankfurt. Many of these discussions were private and off the record; thus what follows is not necessarily the view of any particular individual or institution.
2. The key points of the discussions are as follows:
 - At the official level, the main elements of the Brady framework continue to command general support, and no one thinks that the Brady Initiative should be abandoned or replaced at this time. Nonetheless, no one is satisfied that the three deals negotiated thus far (Mexico, Philippines, Costa Rica) represent a model for the future. There is a high degree of uncertainty as to the direction in which Brady Initiative should be guided now.
 - The Brady Initiative has served to accelerate the exit of banks from Mexico and the rest of Latin America despite the desire of some to either stretch out their disengagement or maintain a presence in some countries. Banks see the Brady Initiative as emphasizing exit by the banks (some cited the Mexicans' explicit statements last Spring that they did not want new money).
 - Brady provides no obvious answer to the issue of future financing for the HICs other than appearing to rely on alleged short memories and greed of commercial banks. As a result, it constitutes a bet that Latin America will either be willing and able to live on domestic savings plus foreign direct investment and official capital, or that banks will return in volume sooner than they say. No one I spoke to considers it realistic to rely on the latter option.
 - The underfunded nature of the Brady Initiative is now obvious. Despite heavy U.S. government intervention, the Mexicans did no better than they would in a buyback at market prices (some say they did worse). The scope for using modest enhancements plus Treasury muscle to force through deep, permanent debt stock reductions is now seen as very limited.

- There is--at best--a good deal of unease on the part of both banks and central banks about the extent to which the Mexico package achieved its objective. The concern is that the package has left Mexico with debt service obligations that are unlikely to be met without further debt restructuring and/or special financing. At the same time, it has alienated a large number of commercial banks from Mexico, Latin America in general, the creditor governments and the Fund/Bank. If things do not go well in Mexico, the official sector will face a dilemma of either allowing Mexico to go into default or supplying additional resources, since restructuring of the bonds is at best uncharted territory and may involve protracted negotiations with a high risk of disruptive litigation.
- The heart of the problem is the emphasis in the Mexico and other negotiations on permanent debt stock reduction. Given the capacity of the banks as a group to resist official pressure, and the limited official resources, the only possible outcome is relatively shallow discounts when the whole of the debt stock is put in play.
- Arrears are now seen as an inescapable component of the Brady Initiative. The banks now view this as a conscious policy of the IMF; some of the creditor governments see arrears as the only means whereby the banks can be induced to accept "reasonable" settlements. No one has an answer to the moral hazard problems associated with arrears. Governments appear to be betting that (a) the banks will prove more flexible within a short period of time; and (b) the borrowers can be induced to maintain financial discipline despite arrears. Banks are preparing for the worst, and believe that official support for arrears represents a U.S. political initiative for Latin America being funded with "other people's money", with the Latins themselves being the biggest losers in the longer run. Central bankers point out that arrears are inherently an undisciplined process and generally lead to a breakdown in domestic economic management.
- Some central bankers see this development as the ultimate defeat of the 1980s debt strategy. Arrears were always a potential "solution", but steadfastly resisted by the Fund in order to maintain the principles of compliance with contractual obligations and negotiated agreements, rather than allowing debtors to resort to unilateral action.
- While there are doubts about the capacity of the official sector to induce appropriate recontracting between debtors and private creditors, the Brady Initiative is seen as particularly weak in this regard because it puts the IMF (and the Bank) more in the role of an observer than was the case in the past, yet refuses to embrace the complete withdrawal of official intervention that some feel is necessary to

provoke appropriate recontracting. Brady is thus seen as a compromise between central management of debt negotiations and a laissez faire approach that gives no clear answers as to how to avoid inadequate debt relief, more official exposure, alienated and damaged banks and no assurance that countries can finance themselves in the future.

- The Fund is sharply criticized by banks for having abandoned its role as a neutral and objective arbiter of balance of payments needs in favor of politically-inspired gap estimates and endorsement of arrears. This is particularly true in Venezuela, where the central banks themselves are unconvinced that Venezuela warrants debt reduction and where the banks have a fairly good sense of the numbers.
- The Brady Initiative is generally seen as having generated unrealistic and wrong expectations on the part of Latin American governments. Some (particularly banks) think this was intentional, naive and foolish, others only see it as regrettable. Most are pessimistic about reversing these expectations and are resigned to a rough and stormy ride.
- The banks are maneuvering to shift the future financing burden to the official sector as much as possible. In the case of Mexico, a number of major banks fully expect the Mexicans to come back to the table within 2-3 years to renegotiate the bonds. While most banks appear to have decided how they would participate in the Mexico package primarily on the assumption that the bonds would be serviced, the downside risk appears to be analyzed on the basis of being able to compel the official sector to provide additional resources in the future to avoid a default on the bonds.

3. In terms of future directions, there appear to be basically three options, all of which are more or less consistent with the basic Brady framework: first, continue along the lines of the Mexican package, i.e. use a combination of official carrots and sticks to achieve the best possible restructuring of debt stock with an emphasis on permanent debt or debt service reductions and simply accept the risks and problems associated with this approach. Second, seek additional official resources for enhancements (and use them more flexibly) so as to achieve deeper discounts and thus more manageable future debt service obligations. Third, back away from the emphasis on permanent reductions in debt stock, focussing instead on (a) deeper debt service reductions over the next few years, and (b) phased debt stock reductions based on market-driven approaches.

4. The first approach seems likely to involve difficult and protracted negotiations, the use of arrears as a tactical weapon at the least, constant strain in trying to fit countries into the Mexico model, severe pressure on the Bank and Fund to maximize up-front disbursements irrespective of performance, ambiguous future burden-sharing and dangerously inflexible debt structures. It will also tend to "corrupt" adjustment programs and financing estimates, and will maximize friction with the banks.

5. The second approach is probably out of the question, especially given the diversion of official resources and attention to Eastern Europe, and the growing realization that official sources will have to play a larger role in future new money for the HICs.

6. The third has its own set of drawbacks. It flies in the face of Latin expectations, reinforced by current attitudes in some Washington circles. Also, while consistent with the principles of the Brady Initiative, it may be viewed as more "muddling through" at a time when political sentiments appear to be in favor of definitive settlements and loss-taking by commercial banks. Nonetheless, I sense that creditor governments may eventually embrace it as offering a better balance among competing objectives than the first option.

7. We will, of course, be incorporating a suitably digested version of these and other findings into the Board paper reviewing the Brady guidelines (scheduled for April 5 Board discussion), balancing our commitments to support the individual transactions agreed thus far with the need to shape support for future negotiations in an appropriate, country-specific way.

cc: Adhoc Brady Initiative Coordinating Committee
(Messrs. Dubey, Goldberg, Linn, Rao, Shilling)

DB/mjw

Distribution:

Messrs. Qureshi, Kashiwaya, Stern, Wood, Roth, Thalwitz, Fischer, Shihata, Husain, Jaycox, Karaosmanoglu, Wapenhans

900130026 2.
January 29, 1990

TO: Distribution

Re: European Financial Seminar

I was asked on short notice to make a presentation on the Brady Initiative to a group of journalists at the European Financial Seminar organized by the Bank's Paris Office.

Attached for your information is the outline of my remarks.


David R. Bock

cc: Adhoc Brady Initiative Coordinating Committee
(Messrs. Dubey, Goldberg, Linn, Rao, Shilling)

DB/mjw

Distribution:

Messrs. Qureshi, Kashiwaya, Stern, Wood, Roth, Thalwitz, Fischer, Shihata, Husain, Jaycox, Karaosmanoglu, Wapenhans

OUTLINE OF REMARKS

1. Introduction

- "Good news/bad news"
- Debt crisis more or less began with Poland in 1981
- As we enter 1990s, problem still with us and Poland once again moving onto the "debt agenda"
- Frustrating. Natural to ask, why is problem still with us? Can't we find a more rapid solution?
- Tonight's talk aimed at putting current phase of debt strategy in context and outlining where we go from here.
- Mainly about middle income, but word at end on low income Africa.

2. Why is Problem Soluttractable?

- "Not in your lifetime"
- Several reasons
 - (1) Global problem affecting future of N/S relations, role of private capital in development
 - (2) Mismatch of sovereign governments and private lenders
 - No legal framework
 - Has to be handled indirectly
 - Depends on weight given by government to relations with external lenders
 - (3) Part of deeper problem of change in development opportunities and strategy
 - Old model of state sector driven growth no longer workable
 - But cannot readily tap foreign savings to make transition
 - Shift to democratic government makes consensus, consistent policy even more difficult
 - Should expect stop/go result

(4) Creditor governments have multiple roles and objectives that need to be balanced

- Regulators of banking systems
- Guardians of international trading and financial systems
- Creditors
- Promoters of peace/stability/democracy

(5) Nature of problem has changed over time and/or taken time to become clear

- Looked more like a liquidity crisis in 82-84, manageable by lending and export expansion
- Persistent high real interest rates, deflationary environment of 1980s, lags in adjustment have converted problem to one of partial insolvency
- Also clear now that 1970s were an aberration in international lending; banks will not be providers of medium-term BOP lending
- Thus, while a strategy of "return to market" made sense in 1982, it has to be reinterpreted now.

3. The Brady Initiative

- Brady Initiative represents that reinterpretation and adaptation of official policy to realities of the marketplace
- Goal is now to bring refinancing requirements down to level that market will provide voluntarily
 - Hence debt and debt service reduction
 - But still arrived at on basis of case by case, voluntary negotiations
- Approach eschews both default/repudiation and creditor-government mandated settlements
- Some official money made available to support process, but purposely less than desired by banks
- Also, regulatory accommodation where feasible
- Other implications:
 - Growth now more sacrosanct
 - Some decoupling of official and private sectors; officials will not hold up disbursements pending bank package
 - Arrears avoidance less of a priority

4. Results to Date

- Three negotiations completed
 - Mexico, Philippines, Costa Rica
 - Each quite different, reflecting circumstances
 - Mexico is comprehensive, limited new money, major restructuring of debt
 - Philippines is new money with buyback in two separate transactions
 - Costa Rica settles arrears, recognizes limited ability to pay
- Banks have strong preference for Philippines due to voluntarism, role of official creditors
- Countries prefer Mexico or Costa Rica due to permanent nature of reductions
- Future negotiations likely to fall into:
 - (a) some combination of Mexico/Philippines for larger countries or those with manageable debt burdens, and
 - (b) Costa Rica-type settlements for countries with protracted arrears

5. Where do we go from here?

- Two points to remember:
 - (1) Brady only a framework; challenge is to implement it forcefully
 - (2) Though no one likes it, no substitute for some official muscle to get deals done
- Official strategy clear enough
 - (1) Adjustment program with Bank/Fund support
 - (2) Concerted official financial support
 - (3) Encouragement to banks and countries to reach appropriate debt agreement
- Clear that this will take time
 - Expectations confused and unrealistic on both sides
 - Concessions not made easily, may see arrears

- Does it represent the ultimate solution?
 - Much too early to tell
 - Has a chance to stabilize debt, provide modest amount of debt relief
 - Major challenge lies in Brazil and Argentina, which are building arrears at an alarming rate
 - Will need flexibility and innovation on part of both countries and banks
 - Keep focussed on restoration of relationships and future financing, not debt reduction per se.

ROUTING SLIP

Date 1/25

OFFICE OF THE VICE PRESIDENT, COFINANCING
AND FINANCIAL ADVISORY SERVICES

Name

Room No.

. Qureshi

For Discussion

Note and File

To Handle

Note and Return

Follow Up

Prepare Reply

Comment

Per Our Conversation

Recommendation

Initial/Signature

Full Report

Send On

For Information

Organize a Meeting

Remarks

I would be happy to discuss with you
this afternoon, if you so wish.

From

Koji Kashiwaya

OFFICE MEMORANDUM

90025014

DATE: January 25, 1990

TO: Mr. Moeen A. Qureshi, Senior Vice President, Operations

FROM: Koji Kashiwaya, CFSVP

EXTENSION: 70795

SUBJECT: IDA Debt Reduction Facility Briefing Note

Eligibility

The IDA Debt Reduction Facility specifies four basic eligibility criteria:

- (1) an on-track, medium-term adjustment program;
- (2) the existence of a debt management strategy acceptable to the Association which:
 - (a) includes a comprehensive program for resolving the commercial debt problem;
 - (b) provides for substantial debt relief from official creditors through the Paris Club; and
 - (c) will materially enhance the country's growth prospects.

Issues

Prospects for Comprehensive Debt Workouts

When the IDA Facility was approved, some members of the Board (e.g. the United Kingdom) expressed the sentiment that Facility funds should not be used to retire debt priced above US\$0.10 of face value. Part of the rationale for this preference was the desire to provide a comprehensive solution to the debt problem of low income countries. During the discussion, staff informed the EDs that the price of low income country debt falls into two distinct categories, debt with steep discounts (80-90% of face value) and debt with shallow discounts (50-60% of face value). Steep country debt discounts typically indicate that a country has not been servicing its debt for some time. Because of the steep discount, the prospects of arriving at a substantial reduction of its outstanding commercial debt are good, but the economic rationale for debt reduction is weak, on a cash flow basis. However, debt reduction can be justified by the longer term strengthening of the country's balance sheet and economic prospects. In contrast, where country discounts are shallow, indicating continued debt service, the economic rationale for debt reduction is stronger on a cash flow basis, but the prospects for arriving at a comprehensive solution to the debt problem are weaker and buybacks would occur at prices in the \$0.20-.50 per \$1 range.

Commercial Bank Reaction to Debt Reduction Proposals

Bolivia is the only case to date on which we have clear commercial bank reaction to a debt reduction scheme for a low income country. Based on this experience and on discussions with banks on other countries, we

have found that banks can be categorized in three general groups: (a) those who for reasons of business philosophy will not extinguish their claims through public buyback schemes (e.g. Citibank); (b) those who for reasons of precedent or balance sheet weakness will not sell (e.g. Standard Chartered); and (c) those who continue to believe that more country resources are available than are being offered. However, it is likely that this third group, plus banks with small holdings, will sell eventually. Creditors in categories (a) and (b) would be more likely to agree to debt conversion and/or exchange offers. Given this diversity of interests in the commercial banking community, we are now less sanguine about the prospects of obtaining comprehensive debt buybacks for low income countries than we were at the time the Facility was proposed. It is important to recognize that the fact that the banks, for the most part, are easily able to absorb significant losses on their low-income country assets, in no way implies that they are necessarily prepared to relinquish their contractual claims to such assets.

Cleared with and cc: John D. Shilling

cc: Messrs. D. Bock, K. Ohashi

AToft/YJones:rpc

TABLE I.
Countries Potentially Eligible for IDA Special Facility Resources

COUNTRY	IDA Adjustment Program	IMF Adjustment Program	Most Recent Paris Club Rescheduling	Commercial Bank Debt (US\$ Mn.)	Share of CB Debt in Tot. DOD	Secondary 3/ Mkt. Price (as of 1/12/90)
Countries that have expressed interest in the IDA Fund:						
Bolivia	SC 87, 88, 89	ESAF	Jul. 86	272.0	4.8%	\$0.10 - \$0.12
Guinea-Bissau	SA 88, 89	SAF	Oct. 87	14.0	3.3%	No activity
Madagascar	SC 87, 88	SAF	Oct. 88	127.0	3.8%	\$0.48 - \$0.51
Mozambique	SA 88, 89	SAF	June 87	292.8	7.5%	\$0.08 - \$0.10
Niger	SC 87	ESAF	Dec. 88	116.0	8.7%	\$0.50 - \$0.53
Sao Tome & Principe	SA 87	SAF	Not resched.	50.0	37.9%	No activity
Senegal	SA 87	ESAF	Jan. 89	124.0	4.5%	\$0.45 - \$0.47
Tanzania	SC 87, 89	SAF	Dec. 88	140.0	5.7%	\$0.10 - \$0.20
Togo	SA 88	SAF	Mar. 88	61.0	5.1%	\$0.43 - \$0.45
Zaire	SA 87	SAF	May 87	480.0	5.5%	\$0.18 - \$0.20
Other Potentially Eligible Countries:						
Benin	SA 89	SAF	Not resched.	35.0	3.0%	\$0.10
Burundi	SA 89; SC 89	SAF	Not resched.	5.0	1.0%	No Activity
Gambia	SA 87, 89	ESAF	Sept. 88	9.0	3.0%	\$0.40
Ghana	SA 89; SC 87, 88	ESAF	Not resched.	121.0	4.0%	\$0.50 - \$0.80
Guinea	SA 88, 89	SAF	Apr. 89	40.0	2.0%	\$0.30
Guyana		No 1/	Not resched.	120.0	7.1%	No activity
Haiti		Stand-by	Not resched.	60.0	8.7%	No activity
Kenya	SC 88, 89	SAF	Not resched.	57.0	1.0%	\$0.97 - \$1.00
Malawi	SC 88	ESAF	Apr. 88	25.0	2.0%	\$0.40 - \$0.50
Mauritania	SC 87	SAF	June 87	7.0	1.0%	\$0.20
Sri Lanka		SAF	Not resched.	700.0	14.8%	No activity

Source: World Bank, DRS.

SA = Structural Adjustment

SC = Sector Adjustment

- NOTE: 1. Guyana has a "Fund Monitored Program" on the basis of which a Stand-by/ESAF will be available to them later this year.
2. External debt figure for Sao Tome & Principe obtained from government's recent letter requesting resources from the IDA-Special Facility.
3. The secondary market prices provided here should be treated with caution due to the thinness of the market for LDC debt with very few transactors and transactions.

SGooptu

TABLE II.
Classification of Countries by Secondary Market Price of Commercial Bank Debt.

Secondary Market Price			
\$0.00 - \$0.18	\$0.19 - \$0.20	\$0.21 +	No Activity
Bolivia *	Zaire *	Madagascar *	Guinea-Bissau *
Mozambique *	Mauritania	Niger *	Sao Tome & Principe *
Tanzania *		Senegal *	Burundi
Benin		Togo *	Guyana
		Gambia	Haiti
		Ghana	Sri Lanka
		Guinea	
		Kenya	
		Malawi	

* = Countries that have expressed interest in the IDA Fund.

TABLE III.
DEBT INDICATORS (as of end-1987) Potentially Eligible Countries for IDA Special Facility Resources

COUNTRY	Total Debt to GDP Ratios (%)			Total Debt to Export Ratios (%)			Per Capita Debt (US\$)
	TOTAL	Concessional	Non-Concess.	TOTAL	Concessional	Non-Concess.	
Countries that have expressed interest in the IDA Fund:							
Bolivia	104.1	27.3	76.8	723.5	189.6	533.9	\$620
Guinea-Bissau	314.0	187.3	126.7	1,781.5	1,082.5	719.0	\$459
Madagascar	163.4	67.4	96.0	813.8	335.6	478.2	\$309
Mozambique	269.0	n.a.	n.a.	n.a.	n.a.	n.a.	\$276
Niger	77.6	32.2	45.4	523.0	217.2	305.8	\$246
Sao Tome & Principe	281.0	208.0	73.0	956.5	703.8	252.7	\$769
Senegal	78.3	36.9	41.4	286.4	134.9	151.5	\$529
Tanzania	123.7	62.1	61.6	965.5	484.6	480.9	\$181
Togo	99.3	41.1	58.2	269.7	111.7	158.0	\$374
Zaire	146.9	47.7	99.2	439.4	142.6	296.8	\$259
Other Potentially Eligible Countries:							
Benin	67.5	27.9	39.6	537.5	222.0	315.5	\$262
Burundi	60.0	50.9	9.1	687.2	582.6	104.6	\$151
Gambia	116.0	79.5	36.5	277.4	190.1	87.3	\$400
Ghana	61.5	32.6	28.9	229.9	71.8	158.1	\$229
Guinea	82.4	53.2	29.2	272.5	175.8	96.7	\$276
Guyana 1/	353.2	177.3	175.9	n.a.	n.a.	n.a.	\$1,016
Haiti	38.2	27.8	10.4	190.6	138.8	51.8	\$133
Kenya	74.0	26.9	47.1	341.9	124.3	217.6	\$268
Malawi	104.2	65.3	38.9	448.1	281.0	167.1	\$181
Mauritania	217.3	139.3	78.0	430.0	275.7	154.3	\$1,092
Sri Lanka	71.1	49.2	21.9	221.2	153.1	68.1	\$289

Source: UNDP-World Bank, "African Economic and Financial Data", September 1989.

NOTES:

1. For Guyana, the debt ratios have been calculated for public and publicly guaranteed debt.

SGooptu

THE WORLD BANK

January 23, 1990

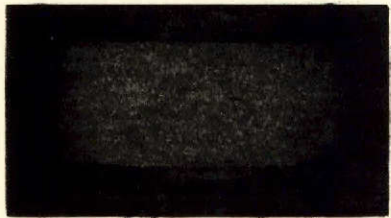
Mrs. Iweala:

Ngozi:

There is merit in the idea of distributing to (Senior) Managers in OPS, the guidelines purely for info. saying in a cover note that these are not final and have not yet been considered by Management. What do you think ?



MOEEN A. QURESHI
Senior Vice President, Operations



THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION
OFFICE MEMORANDUM

900110004

DATE: January 8, 1990

TO: Mr. Moeen A. Qureshi, ONPSV

FROM: John D. Shilling, Manager, CFSFA

EXTENSION: 72773

SUBJECT: Operational Directive on Debt and Debt Service Reduction Operations

CFS has helped COD draft this OD in order to provide some guidance to staff in preparing these operations. The drafts have been circulated widely and substantially revised as a result of comments received from Operating Departments, Legal, and Disbursements. Some further comments have been received on the draft circulated to the OC and can be readily incorporated for the most part, depending on the discussion at the OC.

Preparation of the OD was begun shortly after the Board decision to support debt reduction operations since the Board decision did not contain adequate guidance on the procedures and other technical issues such as disbursements. In view of the uncertainty about how best to proceed and the fact that there was direct senior management involvement in first cases, we did not press to get the OD out too quickly. We have profited from this delay in clarifying a number of issues. We have, however, observed that staff working on countries other than the three with agreements are not clear on appropriate procedures nor familiar with Bank policies on DDRS operations. In view of the necessary improvisation in the first operations, this is not surprising, but it does indicate the need for further guidance. Now that three operations are nearing completion, we should be able to issue some guidance to staff. Perhaps issuing in draft would serve that purpose without losing flexibility for further modifications.

Other than minor editorial adjustments, you may want to raise the issue of how the Bank staff should relate to the negotiations in light of our experience to date. There is considerable uncertainty among staff in the CDs about how closely to become involved in supporting the the country's negotiating position and how to define and articulate limit's on what the Bank will support in DDRS operations.

Concerning Mr. Shihata's points on disbursements: We fully agree that the limitation on beneficiary banks should be dropped, and I believe COD has already so informed Legal. We also agree with Mr. Shihata that the guidelines should not permit disbursement to borrowers except to reimburse them for amounts paid out of their own funds. This is fully covered in paragraph 28, which permits

P. J. Shilling

Ngzi

There is merit in the idea of distributing (senior) managers in ops. The guidelines provide for info, review in a case with less than an final to be made by management. What do you think?

disbursements to agreed agents, to "Separate Accounts" (i.e. special purpose accounts used, for example, to collateralize interest), and to reimburse the borrower for payments made. Section (d) of that paragraph also allows the Bank to agree to other possibilities than what is specifically defined in sections (a-c), but that seems consistent Mr. Shihata's desire not to be too restrictive too soon.

Cleared and cc: Mr. Bock

cc: Messrs. Kashiwaya, Taylor, Elwan, Lee, Siraj

JDShillling:rmc

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OFFICE MEMORANDUM

DATE: January 8, 1990

TO: Mr. Moeen A. Qureshi

FROM: Enzo Grilli, Acting Director, EAS EG ✓

EXTENSION: 78051

SUBJECT: Work on Financial Robustness of Debt Reduction Packages

1. Following up on your instructions I organized two working groups to work on the financial robustness of the debt reduction operations concerning Morocco and Venezuela. I also urged the Region to do something similar for Mexico.

2. You should be receiving by the end of the month the notes on Morocco and Venezuela, and possibly sooner the one on Mexico. After you have reviewed them, you will need to decide on how and when to send them to OC members. I have, in fact, insisted that the notes be prepared for you so that you can share them with the OC as you see fit.

cc: Messrs. Vergin, Dubey (o/r)
Mrs. Iweala

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The World Bank/IFC/MIGA
O F F I C E M E M O R A N D U M

DATE: 03-Jan-1990 08:29pm

TO: David R. Bock (DAVID BOCK)

FROM: Moeen A. Qureshi, OPNSV (MOEEN QURESHI)

EXT.: 73665

SUBJECT: RE: Board Paper on Brady Implementation

David:

Thanks. That's excellent.

CC: John D. Shilling (JOHN D. SHILLING)
CC: Koji Kashiwaya (KOJI KASHIWAYA)

The World Bank/IFC/MIGA
OFFICE MEMORANDUM

DATE: 03-Jan-1990 12:43pm

TO: Moeen A. Qureshi

(MOEEN QURESHI)

FROM: David R. Bock, CFSVP

(DAVID BOCK)

EXT.: 72942

SUBJECT: Board Paper on Brady Implementation

Moeen,

I forgot to mention to you that we have started work on a Board paper reviewing the implementation of the Brady Initiative. This was triggered by your comment at the November Erb meeting that you wanted to revisit the guidelines early in the New Year. I think the basic thrust of the paper should be an assessment of what the three "models" that have emerged thus far imply for the Bank and for other country cases. The heart of the problem is that the Mexico transaction represents an "overdetermined" structure that cannot be applied elsewhere without undermining the IFIs' policy conditionality and risk position. Equally important, it will prove counterproductive in terms of restoring access of the HICs to private markets. What is needed is a more gradualist approach to resolving debt servicing problems, with emphasis on progressive settlements based on performance and gradual provision of additional resources to reduce debt or debt service. The "big bang" approach taken by the Mexicans is not workable elsewhere (indeed has many risks for Mexico itself), and we need to start building a consensus that a more gradualist approach is the right way to go. This will require some adaptation of our guidelines and communication of our views to countries and banks.

We will be sending you an outline of the paper in the next few days for your review prior to circulating it to the Debt Task Force and the Regions.

David

CC: Koji Kashiwaya

(KOJI KASHIWAYA)

CC: John D. Shilling

(JOHN D. SHILLING)

Mr Bock
Sherring
That's excellent.
ADS.
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