Folder Title:	Financial Files - Bank / Fund Debt Task Force - Correspondence
Folder ID:	1103871
Series:	Financial files
Dates:	03/23/1989 - 04/18/1989
Subfonds:	Records of President Barber B. Conable
Fonds:	Records of the Office of the President
ISAD Reference Code:	WB IBRD/IDA EXC-11-48S
Digitized:	04/14/2023

BANK/FUND DEBT TASK FORCE

THE WORLD BANK

ROUTING SLIP	Date April 18, 1989

OFFICE OF THE PRESIDENT

Name	Room No.
Messrs. Qureshi, Stern, Shihata,	
Thahane and Fischer	

	To Handle		Note and File
	Appropriate Disposition		Prepare Reply
	Approval		Per Our Conversation
XX	Information		Recommendation

Remarks

For PreBoard - Tuesday, April 18

URGENT

From

PREBOARD

TUESDAY, APRIL 18, 1989

9:30 a.m.

D E B T

TALKING POINTS

During the meetings of the Development Committee, I had agreed with the Governors and with you that Bank management would report to Board of Directors on issues related to the debt initiative and on possible implementation arrangements.

Today, I would like to let you know where we stand - internally and in consultations with the Fund - and suggest a framework for informal consultations with the Board for the coming weeks.

At present, we are preparing several papers for discussion with the Board:

(a) First, a paper focusing on country eligibility criteria, instrument of possible Bank intervention, funding availability, exposure risks as well as issues of financial assurances; and

(b) Another paper on analytic issues in recent debt reduction on initiatives; and

(c) A paper on foreign direct investment is also under preparation.

I will ask Moeen and Stan to briefly outline to you the content of these papers this morning.

I would hope that we can circulate these papers as informal discussion drafts to you by the beginning of next week.

These papers could then form the basis for a process of consultation and discussion with Board members, including a Committee of the Whole discussion during the week of May 7th, before my departure to the Middle East.

As negotiations proceed, we will also keep you advised about individual country cases which could form the basis for pragmatic approaches to debt reduction.

Moeen, could you please start, reporting on the work underway and the work of the Bank/Fund Task Force on debt.

AGENDA

(Meeting on April 6, 5:30 p.m.)
Conference Room of Managing Director

Joint Bank/Fund Task Force on Debt

1. Objective

Forum to consider, coordinate and agree on debt-related issues of common concern

2. Work Program

Topics for joint consideration:

- country eligibility criteria
- financial assurances (conditionality, tranching, financing package, etc.)
- analysis of alternative methods of debt service reduction
- overall assessment of financing requirements and likely assurances based on a country-by-country review
- regulatory environment

In addition, both institutions will have to:

- assess risk management issues and respective growth of exposure, including alternative possibilities; and
- methods to improve the prospects for
    - foreign direct investments (Bank)
    - return of flight capital (Fund)

3. Logistics

- composition of Task Force
- Arrangement for periodic review
- Timing
- Reporting (internal, Boards, public pronouncements)

Bank Attendance at Joint Meeting on Debt

President

Mr. Hopper, Senior Vice President, Policy, Planning and Research

Mr. Qureshi, Senior Vice President, Operations

Mr. Stern, Senior Vice President, Finance

Mr. Fischer	(Vice President, Development Economics and Chief Economist)
Mr. Shihata	(Vice President and General Counsel)
Mr. Wood	(Vice President, Financial Policy and Risk Management)
Mr. Bock	(Director, Debt Management & Financial Advisory Services)
Mrs. Haug	(Assistant to the President)

Fund attendance at joint meeting on Debt

Managing Director

Deputy Managing Director

Mr. Whittome	(Counsellor and Director, Exchange and Trade Relations Department)
Mr. Frenkel	(Economic Counsellor and Director, Research Department)
Mr. Touré	(Counsellor and Director, African Department)
Mr. Beza	(Director, Western Hemisphere Department)
Mr. Laske	(Treasurer)
Mr. Munzberg	(Deputy General Counsel)
Mr. Watson	(Advisor, Exchange and Trade Relations Department)
Mr. Simpson	(Personal Assistant to the Managing Director)

[Mr. Narvekar (Director, Asian Department) is travelling]

M+I

Bank Attendance at Joint Meeting on Debt

President

Mr. Hopper, Senior Vice President, Policy, Planning and Research

Mr. Qureshi, Senior Vice President, Operations

Mr. Stern, Senior Vice President, Finance

Mr. Fischer	(Vice President, Development Economics and Chief Economist)
Mr. Shihata	(Vice President and General Counsel)
Mr. Wood	(Vice President, Financial Policy and Risk Management)
Mr. Bock	(Director, Debt Management & Financial Advisory Services)
Mrs. Haug	(Assistant to the President)

TALKING POINTS ON DEBT

Key Aim : The real test of any strategy will be whether countries are able to return to the market.

5 Key Principles - The Debt Strategy Should Do The Following.......

I. Differentiate among countries -- it needs to reward and encourage those countries pursuing reform....

2. Be flexible - it must have sufficient options to meet differing country requirements....

3. It must ensure that substantial external resources are available - programs must be adequately and convincingly financed on a medium-term basis.

4. It must continue to be primarily a market-oriented basis...the full involvement of the commercial banks is vital and we cannot substitute for them.

5. The strategy must be designed to accelerate the return to creditworthiness.

You might take the opportunity to go on the record in directly welcoming Secretary Brady's proposals and stating that today's agreement clearly provides encouragement to the Bank and the Fund to move ahead swiftly in evolving the debt strategy.

~~to~~ MH

debt

WORLD BANK OTS SYSTEM
OFFICE OF THE PRESIDENT

CORRESPONDENCE DATE : 89/04/05 DUE DATE : 00/00/00
LOG NUMBER : 890405011 FROM : Mr. Stern
SUBJECT : His comments on the work program submitted by Mr. Fischer at today's meeting on debt.
OFFICE ASSIGNED TO FOR ACTION : Mr. B. Conable (E-1227)

ACTION:

	APPROVED
	PLEASE HANDLE
✓	FOR YOUR INFORMATION
✓	FOR YOUR REVIEW ~~AND RECOMMENDATION~~
	FOR THE FILES
✓	PLEASE DISCUSS WITH BBC
	PLEASE PREPARE RESPONSE FOR ______ SIGNATURE
	AS WE DISCUSSED
	RETURN TO

COMMENTS :

April 5, 1989

Mr. Conable

Barber -

Although I was not invited to this morning's meeting, let me comment briefly on the work program on debt submitted by Messrs. Fischer et al.

First, as to procedures. As far as the Board is concerned, I believe all that is needed is a brief oral statement by you that joint work is in progress and with a follow-up briefing in about four weeks and the promise of a paper to be submitted in May. We certainly should NOT send any papers to the Fund Board -- if that is what is meant by para. IV-2(a) -- either before or after our joint meeting with the Fund.

While it may be possible to have first drafts ready in two weeks, it strikes me as unrealistic that final drafts will be ready in four. But, in any event, the focus should be on the schedule of the Board paper and not on the drafts of the background papers. It is important that we get our proposals right. A good many items need to be considered internally before we can have a comprehensive response. We can hardly afford more uncertainty.

As to the content of the proposed work program, important aspects are missing on which we must take views before a Board paper is submitted, whether or not they are covered in it. These include, at least, the following additional items:

- The role of the bank advisory committees;
- The importance of having the sharing clauses waived and how that objective is to be achieved;
- How do we expect free riders to be handled in the absence of agreement on a moratorium;
- Not only the regulatory environment but what changes, if any, are essential to the implementation of the proposals;
- What conflict, if any, exists between the Brady proposals and the provision of new money; Or with other items on the current memo;
- How do we expect the debt swaps to be organized?
- What minimum criteria would we establish for discounts? For interest coverage?

- o How do we define our role in the negotiation process?

On the other hand, I see no reason to do an analysis of individual or aggregative balance of payments. The numbers are unreliable; the country selections will be controversial; the results inconclusive. It will be the most time-consuming aspect of the work and no conclusions depend on it. Any totals will be unrealistic because not all countries will meet performance criteria simultaneously. In short, I believe we should spend more time in defining parameteres before we start; focus on the Board paper, and keep background papers short; and define an actionable program instead of a general overview.

Ernest Stern

8:30

April 4, 1989

Barber,

In preparation for the 8:30 debt meeting to

a) review where we stand, and
b) agree on an agenda for the meeting with the Fund

I suggest the following approach:

1. Where do we stand with our internal work

- what did we promise at the meetings (report to the Board in 4 weeks, task force with the IMF, etc.)
- what are the outstanding issues where we need internal agreement, i.e.
  - exposure
  - treatment of interest rate guarantees
  - eligibility criteria

Ask Joe wood to start off and ~~summarized~~ summarize where the inter-complex task force stand.

2. Topics and Agenda for meeting with IMF

- what are the issues of common concern?
- country eligibility criteria
- degree of parallel action on
  - set aside amounts
  - interest enhancement
  - tranching
  - conditionality
- extent of assured financing package before proceeding
- role of Advisory Committee, level of significant discounts
- analysis of alternative method of debt service reduction
- respective growth in exposure.

3. Task Force Composition

- who should be changed with the work: Director level? Rao, Bock, Baneth, Morais? or Inter Complex Group i.e. VP
- who should review and direct the task force work?
  - Qureshi/Erb, or
  - Steering Committee including Stern/Qureshi/Hopper/Shihata and equivalent in the Fund.

Attached are some background notes on this issue.

Marianne

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: April 4 1989

TO: Mr. Barber Conable

FROM: Messrs Bock, Fischer, Shihata, Wood.

SUBJECT: Debt Work Program Issues.

I. We met this week to consider our internal work program, and that to be proposed for the Joint Debt Task Force with the Fund. We divided the work into four categories:
(1) work of interest to both institutions to be done jointly
(2) work of interest to each institution that has to be done separately by each for itself
(3) work of interest to both to be done by the Bank
(4) work of interest to both to be done by the Fund.

We propose that the work consist of the following segments, with Bank responsibility for each as described:

1. Joint work:
(a) Country eligibility criteria (Dubey/Holsen)
(b) Financial assurances, i.e. conditionality, tranching, etc. (Dubey/Bock)
(c) Scale, or balance of payments projections, done on a country-by-country basis for the most important cases, and then aggregated into an overall assessment of financing requirements and likely resources (Shilling/Steer/Husain)
(d) Theoretical and empirical analysis of costs and benefits of alternative methods of debt service reduction, e.g. buybacks versus interest reduction (Fischer)
(e) Regulatory environment (Bock/Morais)

2. Work to be done by each institution on its own behalf:
(a) Implications of the Brady Plan for risk management and resource requirements, including alternative possibilities (D.C. Rao)
(b) Techniques of debt service reduction that would be supported by these resources (Bock)

3. Work of joint interest to be done by the Bank:
Methods to improve the prospects for foreign direct investment (Gelb)

4. Work of joint interest to be done by the Fund:
Methods to improve the prospects for the return of flight capital.

II. Policy Papers. Separate papers, based on the preceding work, will have to be prepared by the management of each institution setting out the management's recommendations. We may nonetheless want to consider submitting some of the joint studies as background documents.

III. Schedule. We believe that first drafts of all the papers should be ready within two weeks, and final drafts within four.

IV. Decisions.

1. We need to finalize the proposals we will offer at tomorrow's joint meeting with the Fund, and send them over to the Fund as soon as possible.
2. You may want to consider how to keep the Board informed:
(a) You could send them (and perhaps also the Board of the Fund) a copy of the proposed work program we send to the Fund
(b) You could wait until the meeting with the Fund and then inform the Boards of the joint work program.

cc: Messrs Hopper, Qureshi, Stern

WB/fund
Debt
JF
JWS
file

WORLD BANK OTS SYSTEM
OFFICE OF THE PRESIDENT

CORRESPONDENCE DATE : 89/03/30 DUE DATE : 00/00/00
LOG NUMBER : 890330012 FROM : David Rockefeller
SUBJECT : Mtg. with Sec. Brady and Assist. Secretaries Dallara and Bolton.
Attached is a copy of memo: Further Steps on Third World Debt.
OFFICE ASSIGNED TO FOR ACTION : Mr. B. Conable (E-1227)

ACTION:

	APPROVED
	PLEASE HANDLE
✓	FOR YOUR INFORMATION
	FOR YOUR REVIEW AND RECOMMENDATION
	FOR THE FILES
	PLEASE DISCUSS WITH ______
	PLEASE PREPARE RESPONSE FOR ______ SIGNATURE
	AS WE DISCUSSED
	RETURN TO ______

COMMENTS :cc: Messrs. Fischer, Qureshi, Stern

30 Rockefeller Plaza
New York, N.Y. 10112

Room 5600

(212) 649-5600

March 30, 1989

Dear Barber:

First of all, a great many thanks to you for inviting our Ad Hoc Debt Group to lunch with you and some of your senior colleagues on Tuesday. We very much enjoyed being with you.

This morning, our group met with Secretary Brady and Assistant Secretaries Dallara and Bolton. We gave them a presentation similar to the one that we gave to you and left with them a copy of a paper we had prepared. Thinking you might be interested to see it, I attach a copy of the memorandum to this letter.

Best regards.

Sincerely,

David

David Rockefeller

The Honorable Barber B. Conable
President
International Bank for Reconstruction
and Development
1818 H Street, N.W.
Washington, D.C. 20433

FAX #: 202-477-1315

FURTHER STEPS ON THIRD WORLD DEBT

1. The Administration's new initiative is welcome. The extension of the strategy to encompass debt reduction and debt service reduction is necessary and desirable.

2. It seems unlikely, however, that the new proposals on debt reduction and debt service reduction will have sufficient impact in the immediate future to adequately reduce the negative financial transfer from the debtor countries, which has approximated $30 billion in recent years and is rising due to higher interest rates. Thus they will not meet the high expectations which have developed in Latin America and defuse the political tensions there, nor will they significantly improve the creditworthiness of the debtor countries.

3. The proposals must therefore, in particular, do more to encourage new flows of funds from all sources, which will be needed for some period even if the proposals for debt/debt service reduction are ultimately successful. This more comprehensive approach could best be launched through an initial package negotiated between the banks and Mexico.

4. Three issues are of most concern:

   a. The modest scope of the debt reduction measures, and the apparently modest degree of additionality of resources to be made available to support debt reduction and debt service reduction.

   b. The absence of any discussion of the contributions of government creditors to debt reduction.

   c. Most importantly, the lack of emphasis on promoting flows of new money, both private and public, to the debtor countries.

5. Several elaborations of the debt/debt service reduction part of the proposed strategy would be desirable:

   a. Commitments to assure that funds provided by the international financial institutions, to induce voluntary debt relief by the banks, are additional to credits that would have been extended anyway to the debtor countries. (This would not require any early augmentation of resources of the institutions, though it might advance the dates of the next General Capital Increase at the World Bank and IMF quota increase by a year or so in the early or middle 1990s.)

b. A major effort to promote and fund such additionality by attracting the maximum amount of additional capital from Japan and other creditor countries, at the most concessional possible terms. Appropriate changes in the institutional role of these countries, particularly Japan, should be accorded in return.

c. Collateralization of three years of rolling interest cover on the new debt reduction instruments (which could better be provided through World Bank guarantees than the techniques now apparently envisaged).

d. Maintenance of the debt-equity option (and insistence on debtor country hospitality toward incoming direct investment).

e. More emphasis on debt service reduction, which provides greater immediate relief to the debtor country, than on debt reduction techniques.

f. Eligibility for the new program should be strictly reserved for countries which have demonstrated a commitment to structural reform and are not in arrears or default under their debt agreements.

6. The most significant shortfall in the strategy may lie in its failure to provide an assured flow of sufficient new money. Such a flow will be essential in both the short and longer runs, whatever success is achieved through debt relief. It is unrealistic to rely on repatriation of flight capital to provide such financing; repatriation is of critical importance but cannot be counted on until later in the adjustment period, when confidence in economic and political stability has been re-established. Private banks should choose among a variety of techniques including:

a. Bearer bonds (with the usual lockup periods), which should become the preferred technique for new loans because of their implied seniority and good record to date even in countries which have stopped servicing their banks loans.

b. Co-financing. The IBRD should offer mandatory cross-default clauses and sharing provisions in its co-financing programs. Optional cross-default clauses have proven to be worthless. The proposed conditions would apply only to specific B-loans and any impact on the balance of the IBRD portfolio would depend on the policy of the IBRD.

c. Medium-term trade facilities.

d. Project finance.

e. On-lending and relending.

f. Partial interest capitalization on an optional basis where necessary.

g. Extension of the debt-equity approach to include partial payment of interest in local currencies to be used for equity investment.

7. All banks should contribute a fair share through debt/debt service reduction and/or some of the mechanisms cited above for providing new money. No assistance in recovering arrears should be accorded to free riders.

8. Larger extensions of credit by public institutions should be added to the package:

a. Export credit agencies: In the case of the United States, much greater funding and more aggressive use of the Export-Import Bank is in any event needed to promote exports to the debtor countries to help reduce our trade deficit.

b. The World Bank, Inter-American Development Bank and International Monetary Fund. To reward (and induce) more effective an sustained policy reforms, considerably larger commitments and faster disbursements (via structural adjustment loans in the IBRD and sector loans in the Inter-American Development Bank) are needed.

c. Debt service reduction from governmental creditors.

9. These suggestions would result in a larger role for the multilateral financial institutions, in both absolute and relative terms, than envisaged in the Administration's proposals. Implementation of such an enhanced role would require much more active and consistent engagement by the major donor countries; with such engagement, however, there should be good prospects for effective use of the institutions' resources and for inducing the debtor

countries to adopt and maintain more effective policies. With regard to financing:

a. The IBRD has just acquired about $75 billion of additional capital. The added responsibilities suggested here could accelerate the use of those resources by a year or two, advancing the need for the next General Capital Increase by a year or so. (Selective Capital Increases for Japan and other creditor countries could also provide additional funds.)

b. The new initiative already envisages agreement on a quota increase for the IMF by the end of 1989, which we strongly support. Increasing the magnitude of the Fund's country programs could accelerate the need for the subsequent quota increase by a year or so. (Additional funds could be borrowed directly from Japan and others.)

c. Early implementation of the agreed capital increase for the Inter-American Development Bank.

AD HOC DEBT GROUP

Robert R. Bench	Price Waterhouse; Former Deputy Comptroller of the Currency
C. Fred Bergsten	Institute for International Economics; former Assistant Secretary of the Treasury - International Monetary Affairs
Richard J. Boyle	Chase Manhattan Bank (Vice Chairman)
Robert Carswell	Shearman & Sterling (Senior Partner); former Deputy Secretary of the Treasury
Thomas O. Enders	Salomon Brothers; former Assistant Secretary of State for Inter-American Affairs
Martin S. Feldstein	Harvard University; former Chairman, Council of Economic Advisors
Thomas G. Labrecque	Chase Manhattan Bank (President)
George W. Landau	Americas Society (President); former U.S. Ambassador to Chile, Paraguay and Venezuela
John G. Medlin, Jr.	Wachovia Bank & Trust Co. (Chairman)
John S. Reed	Citicorp (Chairman)
William R. Rhodes	Citicorp (Group Executive Chairman, Restructuring Committee)
David Rockefeller	Americas Society (Chairman); former Chairman, Chase Manhattan Bank
Paul A. Volcker	James Wolfensohn & Co.; former Chairman, Federal Reserve Board

30 Rockefeller Plaza
New York, N. Y. 10112

Room 5600

telephone: (212) 649-5600

telefax: 212/765-6817

TO: The Honorable Barber B. Conable

FROM: David Rockefeller

Total number of pages, including cover sheet: ~~6~~ 7

WORLD BANK OTS SYSTEM
OFFICE OF THE PRESIDENT

CORRESPONDENCE DATE : 89/03/23 DUE DATE : 00/00/00
LOG NUMBER : 890323005 FROM : Bock, Fischer, Shiha
SUBJECT : The Brady Plan: Issues for the World Bank

OFFICE ASSIGNED TO FOR ACTION : Mr. B. Conable (E-1227)

ACTION:

_________ APPROVED
_________ PLEASE HANDLE
_________ FOR YOUR INFORMATION
_________ FOR YOUR REVIEW AND RECOMMENDATION
_________ FOR THE FILES
_________ PLEASE DISCUSS WITH _______________
_________ PLEASE PREPARE RESPONSE FOR _________ SIGNATURE
_________ AS WE DISCUSSED
_________ RETURN TO _______________

COMMENTS :

FOR: Meeting with Mr. Conable at 12 noon on 3/23/89.

URGENT

THE WORLD BANK / INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

March 23, 1989

TO: Mr. Barber Conable, EXC

FROM: D. Bock, DFS, S. Fischer, VPDEC, I. F. Shihata, LEGVP, SF
D. Joseph Wood, FPRVP

SUBJ: **The Brady Plan: Issues for the World Bank**

There are six major issues surrounding the Bank's participation in the Brady Plan:

1. Adequacy of resources relative to the size of the problem. The amounts apparently available for debt reduction appear, from preliminary calculations, inadequate to address the total funding problems of the Brady countries. Some countries will need new commercial bank money. It will be essential in each case to work out a full funding plan that takes into account the amount of debt relief and new money. The forms of debt reduction sanctioned by the Brady Plan must not preclude commercial bank participation in providing new money in whatever form in sufficient amounts.

2. Country eligibility. (a) It is necesssary to develop objective criteria by which countries become eligible for this program. We have to deal with difficult questions about how to treat countries that have been promptly and regularly servicing their debt, despite heavy debt burdens, but whose debt is not selling at discount. (b) Only those countries which have a comprehensive medium-term adjustment program and a viable financing plan should be eligible.

3. Adjustment programs and financing plans. The Bank and Fund will have to agree on a debtor country's adjustment program and on the country's financing plan. Release of tranches would be linked to demonstrated performance of conditionality laid down in the program. Additionally, there should be a precondition for bank support that it will only finance debt relief if a country has negotiated a minimum discount on the existing debt with its commercial bank creditors.

4. Form of debt reduction. The advantages of alternative forms of debt reduction for the debtors and for the Bank have to be considered: (a) The initial proposals for debt reduction are reduced interest rate, debt exchanges, debt buybacks, debt-equity swaps etc. (b) If the Bank provides credit enhancement for interest rate reduction we have to examine whether in each case it should take the form of guarantees, standby line of credit, straight loans or some other alternate or hybrid form of guarantee or lending. (c) Alternative forms of debt reduction, including interest rate reduction for specified period for say five years, may need to be explored.

5. <u>Tax and regulatory measures</u>. Since preliminary analysis shows a significant funding problem despite Brady debt reduction measures, industrial country tax and regulatory changes will have to be an essential component of the Plan. These changes should be in place before or concurrently with Bank and Fund assisted debt reduction programs. The changes should aim at providing incentives for the banks to participate in debt reduction and penalizing free riders

6. <u>Availability of additional official financial resources</u>. Since the resources of the Fund and Bank may not be adequate to address the needs of the Brady countries, (in part because funds used in buybacks are not available for investment), it will be important to seek alternate sources of official finance.

These issues are examined in more detail in the attached note.

DECVP

March 23, 1989

The Brady Plan: Issues for the World Bank

I. **Adequacy of resources relative to the size of the problem** How much debt relief is possible through this initiative? Does the scheme, as now envisioned, provide the amount of relief that is necessary for adequately funded adjustment programs. The actual relief, i.e., the reduction in net resource transfers by debtor countries to their creditors will depend on a number of factors: (a) the size of the discount on the existing loans; (b) the form of debt reduction, e.g., buy back, interest rate reduction, etc.; (c) the differential in interest rate between the commercial bank and the WB/IMF loans used for debt reduction; (d) the additionality of new money and net lending from commercial banks and/or officials sources and (e) the strength of the tax and regulatory measures. We have reached three tentative conclusions:

> Preliminary analysis indicates that the amounts apparently available for debt reduction will not be adequate to meet the total funding problems of the Brady countries.
>
> Our preliminary calculations show that if the discount is reasonable, the exchange offers with reduced interest rates may be a more attractive option than the debt buy backs, at least in large countries whose debt is owed mainly to commercial banks.

New money, in the least debt distressed countries, and some method of further "leveraging" IFI and other official funds are likely to be required if the Brady scheme is to succeed. That leverage could take the form of official tolerance of arrears to free riders and favorable tax and regulatory treatment of debt exchanges.

It may be that new money will be part of financing perhaps for the large countries while small countries are financed mainly through debt reduction.

II. Country Eligibility. The Bank and Fund must develop objective criteria for the identification of countries eligible for the program. The 39 countries identified by the Treasury as eligible for assistance (on the basis of having rescheduled commercial bank debt since 1983) include ten small African countries that owe less than 10 percent of their debt to commercial banks. Major commercial bank debtors such as Colombia and Hungary are excluded. The Bank and Fund Boards must deal with the problem of the eligibility of countries that have been prompt in servicing their debts, despite liquidity problems, but whose debt is not selling at a discount. To be eligible, a country must have in place a comprehensive adjustment program and have worked out a viable financing plan.

III. Adjustment programs and Financing Plans. The Bank must address a set of issues relating to adjustment and financing plans:

(a) Who "approves" the financing plan of an eligible debtor country? The Bank and Fund should be in agreement on the plan, if the country has to establish access for financial assistance. In that event, the two institutions have to develop joint criteria as to the content of an acceptable Brady Plan adjustment program.

(b) What are the criteria for the provision of new money versus debt reduction in a financing plan? The Bank, Fund, and regulatory authorities must consider their policy stance concerning arrears to commercial bank creditors that resist negotiating or signing agreements which fit in an "approved" financing plan.

(c) The Bank should insist on a threshold discount in debt reduction agreements as a precondition for its support. Otherwise the Bank faces the danger of creditor debtor agreements which unduly benefit commercial banks at the expense of the debtor country and the World Bank.

(d) Bank and Fund support must be tranched to achieve the maximum policy performance leverage. The Bank and Fund will be taking on a high level of risk. The two institutions must be assured that the funds to be made available will be used efficiently. Release of tranches must be made conditional on demonstrated performance under negotiated adjustment programs.

IV. <u>Forms of Debt Reduction</u>. Again the Bank faces a set of issues:

(a) Debt relief can take several forms: new money; cash buy-backs; old debt for new debt exchanges in which the new debt carries a lower face value (Mexico-Morgan) or a lower interest rate (Brazil exit bonds); and debt-equity swaps. Debt exchanges can be "credit enhanced" through guarantees, collateral, or some form of senior creditor status. In the extreme, a fully guaranteed or collateralized exchange is equivalent to a buyback.

(b) Bank credit enhancement techniques must be examined. Alternative forms of credit enhancement include guarantees, lending for collateral to be placed in escrow accounts, stand-by lines of credit or combinations of these techniques. At an abstract level, all forms of credit enhancement are equivalent. However, Bank bondholders, commercial banks and their regulators, and the debtor countries may value these instruments differently. The Bank should investigate the advantages and disadvantages of alternative credit enhancement techniques.

(c) Our preliminary analysis indicates that, for some debtor countries, an assured stream of new money may be adequate without need for any debt reduction. Since it is likely that most of the countries would, on political grounds, ask for debt relief the real issue is the proportion in which the financing gap is filled through debt reduction and new money. Should the Bank support interest capitalization in these countries and push for favorable regulatory treatment of capitalized interest? Alternatively, should new money be credit enhanced by the Bank and Fund? Should the countries receiving new money be allowed to buy back debt if they are in compliance with their adjustment program and are current on interest?

(d) Many debtor countries require debt reduction. Forms of debt exchange that provide immediate interest rate reductions appear to provide the biggest cash flow advantage. Interest rate reduction for a specified period of time, five years for example, appears to be an attractive option to consider.

(e) The type of conditionality connected with Bank financial support will be affected by the form of debt relief. New money can be tranched. Buybacks would require prior adjustment measures. Debt exchanges can be designed to provide relief conditional on policy performance. For example, interest can be reduced if adjustment measures are followed or capitalized if policy performance deteriorates.

(f) What will be the sequencing of debt relief? Should it be done in a series of operations or relatively quickly? If pure buybacks are the major tool, sequencing provides a greater degree of policy conditionality leverage. Immediate cash-flow needs argue for quick debt exchange agreements with commercial creditors, incorporating conditional interest rate reductions.

(g) Pricing of debt buybacks and exchanges is also an issue. Should the prevailing secondary market price be taken as a rough benchmark? Should the pricing be left to negotiations between creditors and the debtor country? There should be a minimum discount below which the Bank should not use its resources to support debt reduction. Prices will tend to rise as new resources are devoted to buybacks; commercial banks may tend to benefit disproportionately. A minimum discount would help to alleviate this problem.

V. Tax and regulatory measures.

(a) Preliminary analysis indicates that the debt reduction measures envisioned in the Brady Plan will not be adequate to meet the financing needs of the Brady countries. Tax and regulatory measures will be required to ensure that commercial banks do their share. Free riders must be penalized for nonparticipation in new money or debt reduction exercises. For example, free riders could be forced to create non-tax deductible reserves, separate from capital, while participating banks are allowed to count interest paid as a part of income. Regulatory and tax authorities should consider favorable treatment of payment in local currency.

(b) The importance of these tax and regulatory measures means that they cannot be delayed; these changes should be negotiated quickly. These measures must be in place before or concurrent with the introduction of Bank and Fund assisted debt reduction plans.

VI. Availability of Official Financial Resources. Unless debt reduction is significant, it will not meet the financing needs of the eligible countries. As noted above, our preliminary analysis indicates that the level of support currently envisioned from the Bank and the Fund, while likely at the limit of prudency for the two institutions, would not be adequate to meet the financing needs of the Brady countries. How firm is the support of the Japanese for the Plan? Can they, and other surplus countries, contribute additional amounts?