Collection: Robinson, Roger W.: Files
Folder Title: International Finance
03/02/1983-03/31/1983
Box: RAC Box 3

WITHDRAWAL SHEET

Ronald Reagan Library

Collection Name Robinson, Roger: Files

Withdrawer SRN 2/15/2012

File Folder INTERNATIONAL FINANCIAL: 03/02/1983-03/31/1983

FOIA F01-052/3 GRYGOWSKI

Box Number 3

20

ID	Doc Type	Document Description	No of Pages	Doc Date	Restrictions
131210	DRAFT NSSD	RE: U.S. APPROACH TO THE INTERNATIONAL DEBT PROBLEM	2	ND	B1
131211	MEMO	ROGER ROBINSON TO WILLIAM CLARK RE: DRAFT NSSD	2	3/7/1983	B1
131212	MEMO	ROGER ROBINSON TO WILLIAM CLARK RE: NSSD	1	3/10/1983	B1
131213	MEMO	ROGER ROBINSON TO WILLIAM CLARK RE: BRAZIL'S COMMERCIAL BANK	2	3/11/1983	B1
131214	MEMO	NORMAN BAILEY TO WILLIAM CLARK RE: DEBT STRATEGY	2	3/31/1983	B1

The above documents were not referred for declassification review at time of processing

~~SECRET~~

THE WHITE HOUSE

WASHINGTON

System II
90256

1

Int Fu

March 7, 1983

~~CONFIDENTIAL~~ with
~~SECRET~~ ATTACHMENT

Don

MEMORANDUM FOR THE HONORABLE DONALD T. REGAN
The Secretary of the Treasury

SUBJECT: Draft NSSD on U.S. Approach to the International Debt Problem ~~(C)~~

Consistent with our discussion earlier today, please find attached (Tab A) a proposed draft NSSD on the U.S. approach to the international debt problem for Treasury's comments. If possible, I would appreciate receiving any revisions and a final NSSD by COB today for signing by the President at tomorrow's 0930. I would also request that you send Roger Robinson of my staff the final draft as soon as it is completed. ~~(C)~~

FOR THE PRESIDENT:

Bill

William P. Clark

Attachment
Tab A Draft NSSD

~~CONFIDENTIAL~~ with
~~SECRET~~ ATTACHMENT
DECLASSIFY ON: OADR

DECLASSIFIED
Sec.3.4(b), E.O. 12958, as amended
White House Guidelines, Sept. 11, 2006
BY NARA ssn , DATE 02/15/2012

~~SECRET~~

WITHDRAWAL SHEET

Ronald Reagan Library

Collection Name	*Withdrawer*
Robinson, Roger: Files	SRN 2/15/2012
File Folder	*FOIA*
INTERNATIONAL FINANCIAL: 03/02/1983-03/31/1983	F01-052/3 GRYGOWSKI
Box Number	
3	20

ID	*Document Type* *Document Description*	*No of pages*	*Doc Date*	*Restrictions*
131210	DRAFT NSSD RE: U.S. APPROACH TO THE INTERNATIONAL DEBT PROBLEM	2	ND	B1

National Security Council
The White House

4

MAR 0 7 1983

Package # 90256

1545

	SEQUENCE TO	HAS SEEN	ACTION
John Poindexter	1	P	A
Bud McFarlane	2	separate	
Jacque Hill	3	✓	
Judge Clark	4	✓	A
John Poindexter			
Staff Secretary			
Sit Room			
Robinson	5		A

I-Information A-Action R-Retain D-Dispatch N-No further Action

DISTRIBUTION

cc: VP Meese Baker Deaver Other______

COMMENTS

Judge,

This gives them 4 weeks to produce a study and then about 2 weeks to review before we get it for the President. P

P.S. Roger did a great job with fast response

WITHDRAWAL SHEET

Ronald Reagan Library

Collection Name	*Withdrawer*
Robinson, Roger: Files	SRN 2/15/2012
File Folder	*FOIA*
INTERNATIONAL FINANCIAL: 03/02/1983-03/31/1983	F01-052/3 GRYGOWSKI
Box Number	
3	20

ID	*Document Type* *Document Description*	*No of pages*	*Doc Date*	*Restrictions*
131211	MEMO ROGER ROBINSON TO WILLIAM CLARK RE: DRAFT NSSD	2	3/7/1983	B1

The above documents were not referred for declassification review at time of processing

Freedom of Information Act - [5 U.S.C. 552(b)]

B-1 National security classified information [(b)(1) of the FOIA]
B-2 Release would disclose internal personnel rules and practices of an agency [(b)(2) of the FOIA]
B-3 Release would violate a Federal statute [(b)(3) of the FOIA]
B-4 Release would disclose trade secrets or confidential or financial information [(b)(4) of the FOIA]
B-6 Release would constitute a clearly unwarranted invasion of personal privacy [(b)(6) of the FOIA]
B-7 Release would disclose information compiled for law enforcement purposes [(b)(7) of the FOIA]
B-8 Release would disclose information concerning the regulation of financial institutions [(b)(8) of the FOIA]
B-9 Release would disclose geological or geophysical information concerning wells [(b)(9) of the FOIA]

C. Closed in accordance with restrictions contained in donor's deed of gift.

WITHDRAWAL SHEET

Ronald Reagan Library

Collection Name Robinson, Roger: Files	*Withdrawer* SRN 2/15/2012
File Folder INTERNATIONAL FINANCIAL: 03/02/1983-03/31/1983	*FOIA* F01-052/3 GRYGOWSKI
Box Number 3	20

ID	*Document Type* *Document Description*	*No of pages*	*Doc Date*	*Restrictions*
131212	MEMO ROGER ROBINSON TO WILLIAM CLARK RE: NSSD	1	3/10/1983	B1

The above documents were not referred for declassification review at time of processing

Freedom of Information Act - [5 U.S.C. 552(b)]

B-1 National security classified information [(b)(1) of the FOIA]
B-2 Release would disclose internal personnel rules and practices of an agency [(b)(2) of the FOIA]
B-3 Release would violate a Federal statute [(b)(3) of the FOIA]
B-4 Release would disclose trade secrets or confidential or financial information [(b)(4) of the FOIA]
B-6 Release would constitute a clearly unwarranted invasion of personal privacy [(b)(6) of the FOIA]
B-7 Release would disclose information compiled for law enforcement purposes [(b)(7) of the FOIA]
B-8 Release would disclose information concerning the regulation of financial institutions [(b)(8) of the FOIA]
B-9 Release would disclose geological or geophysical information concerning wells [(b)(9) of the FOIA]

C. Closed in accordance with restrictions contained in donor's deed of gift.

SYSTEM II
90256

8

THE WHITE HOUSE

WASHINGTON

~~SECRET~~

NATIONAL SECURITY STUDY DIRECTIVE NUMBER

U.S. APPROACH TO THE INTERNATIONAL DEBT PROBLEM

Introduction

This National Security Study Directive establishes guidelines for a review of the U.S. approach to the international debt problem. The current international economic environment and financing constraints are requiring substantial economic adjustments by borrowing countries, entailing in part reductions in the pace of economic growth, and inhibiting their ability to adjust through export expansion. The consequences and management of the current world financial situation affect other areas of critical concern to the United States and other industrialized democracies, including the international trading system, economic recovery and employment prospects and international political stability. The review should take as its starting point the analysis and strategy developed under the auspices of the SIG-IEP and should utilize the following guidelines for further analysis and consideration of alternative or additional management and policy responses by the United States.

Scope

The NSSD will cover the following topics:

I. Dimensions of the Debt Situation and the U.S. Approach to Resolving It

II. Implications of the Debt Situation for International Trade and Trade Policy

III. Effects on U.S. Domestic Economy

-- Employment

-- Non-inflationary growth

IV. Macroeconomic Considerations

-- The implications of the debt situation for U.S. and world recovery.

~~SECRET~~
DECLASSIFY ON: OADR

DECLASSIFIED
List 10/15/2010
Authority Leary to Weinstein letter, 04/20/2005
BY ssn NARA DATE 02/15/2012

9

-- The implications of alternative world growth results for the debt situation.

V. Political and Security Considerations

VI. The U.S. Policy Response

-- Adequacy of the present strategy

-- Alternative or additional measures

-- Administration/management questions

-- Public affairs/legislative questions ~~(S)~~

Administration

The review will be conducted by an interagency group, composed of representatives of the members of the SIG-IEP, responsible for existing interagency work on the debt situation, utilizing the working groups already established in the areas listed above and such other working groups as may be necessary. The interagency group will report to the SIG-IEP, whose Chairman will be responsible for scheduling and management of the review. ~~(C)~~

The review, with recommendations, should be forwarded to the Assistant to the President for National Security Affairs no later than April 15, 1983, for review and decision by the President. (U)

WITHDRAWAL SHEET

Ronald Reagan Library

Collection Name	*Withdrawer*
Robinson, Roger: Files	SRN 2/15/2012
File Folder	*FOIA*
INTERNATIONAL FINANCIAL: 03/02/1983-03/31/1983	F01-052/3 GRYGOWSKI
Box Number	
3	20

ID	*Document Type* *Document Description*	*No of pages*	*Doc Date*	*Restrictions*
131213	MEMO ROGER ROBINSON TO WILLIAM CLARK RE: BRAZIL'S COMMERCIAL BANK	2	3/11/1983	B1

The above documents were not referred for declassification review at time of processing

Freedom of Information Act - [5 U.S.C. 552(b)]

B-1 National security classified information [(b)(1) of the FOIA]
B-2 Release would disclose internal personnel rules and practices of an agency [(b)(2) of the FOIA]
B-3 Release would violate a Federal statute [(b)(3) of the FOIA]
B-4 Release would disclose trade secrets or confidential or financial information [(b)(4) of the FOIA]
B-6 Release would constitute a clearly unwarranted invasion of personal privacy [(b)(6) of the FOIA]
B-7 Release would disclose information compiled for law enforcement purposes [(b)(7) of the FOIA]
B-8 Release would disclose information concerning the regulation of financial institutions [(b)(8) of the FOIA]
B-9 Release would disclose geological or geophysical information concerning wells [(b)(9) of the FOIA]

C. Closed in accordance with restrictions contained in donor's deed of gift.

Draft

Roger Robinson 12
I'll call Monday, P.M. Thanks,
Nat McK

OPERATION DEBT WATCH

Sponsored by

The International Public Policy Foundation

I: Introduction and Purposes:

Is the current crisis in the international financial system a system-wide liquidity crisis, caused primarily by the recession, falling commodity prices and historicly high interest rates?

Or is the current crisis a system-wide structural crisis, the result of more than a decade of "banking on inflation" from the Viet Nam war to the second OPEC oil price shock in 1979?

It is to be devoutley hoped that it is a liquidity crisis. If so, the present policies of increasing the capacities of traditional sources of emergency finance (IMF quotas, [redacted] General Arrangements to Borrow, bridge loans from central banks, and renewed commercial bank commitments) should be adequate to provide the needed liquidity until a resurgence in world trade, lead by a sustained recovery in the U.S. economy, restores a new order to the system.

But if it is a system-wide structural crisis, the prescribed remedies not only will fail to help; they will further strain the structures of the system by adding more layers of debt. Then the twin prospects of renewed, rampant inflation, resulting from the printing of money (or SDRs), and a system-wide break down will become very real and apparent.

OPERATION DEBT WATCH is designed:

a) To monitor in periodic reports the points of vulnerability in the international financial system (see below) in order to provide a running account of data and experience with which to test whether or not it is a liquidity crisis or a structural crisis;

b) To provide occasional papers on alternatives to current policies that might better serve to ~~xxxxxxx~~ overcome a structural, rather than a liquidity crisis.

It is <u>not</u> the purpose of OPERATION DEBT WATCH to examine the historical causes of the present crisis. It says in the Book of Isaiah that "no man, having put his had to the plow and looking back, is fit for the Kingdom of God." This injunction applies with particular force to the current crisis. The surest way to confound and confuse public discussion of this crisis is to try to affix blame for its onset. OPERATION DEBT WACTH rests on the contention that practically everybody is to blame, governments, banks, parliaments and interest groups in general.

However, the risks in the present situation are so great that careful contingency planning is an absolute necessity. OPERATION DEBT WATCH exists to encourage careful preparation and forethought. The international financial system, besides being a major generator of economic growth and employment in the United States, is part of the foundation of the Western Alliance. As such, abrupt or paniky policy action by the Alliance governments could be as damaging to the security of the alliance as a failure to be prepared militarily or to reach a strong political consensus. The threat to this part of the alliance foundation will be the single most important threat if ~~xx~~ the current crisis turns out to be structural rather than simply a matter of liquidity.

II: <u>Monitoring Points of Vulnerability.</u>

OPERATION DEBT WATCH ~~WILLxMONITOR~~ will monitor the following points of vulnerability in the international financial system:

1) <u>Growth in World trade:</u> If it is a liquidity crisis, what level of world trade will have to be achieved in order to "grow out" of the crisis? (Wharton study) What are the key country markets that threaten to be serious bottlenecks in the expansion of world exports? (Table by Dr. Seiber and Mr. Luft).

2) <u>The Domestic Effects of the foreign obligations of U.S. Banks:</u>

a) on the availability of loan capital for domestic recovery;

b) on domestic interest rates.

c) on bank earnings.

3) <u>Success in meeting IMF targets:</u> Country by country. "Second round" problems.

4) <u>BREADTH of Participation by U.S. and other commercial banks in foreign lending:</u>

a) Relative burden on Big Nine banks;

b) Evidence of stockholder revolt;

c) Changes in patterns of global participation (i.e. withdrawal of Arab banks from Latin America; regional preferences of EEC and Japanese banks.)

5) <u>Trends in Inter-Bank and Eurocurrancy Markets</u>. Evidence of multiplier effect.

6) <u>Trends in "tenor-matching"--Maturity of loans vs. Life of Transactions.</u> Re-scheduled ings, terms and conditions.

7) <u>Effects of Oil Price Changes on Producers and Consumers.</u>

8) <u>Effects on Bank Earnings of Proposed Increases in Regulation</u>:

a) Reserves against problem loans.

b) Amortization of front end fees for rescheduling services;

c) Full disclosure requirements.

OPERATION DEBT WATCH welcomes notification from readers of any on-going research or monitoring related to the above questions.

Sent Friend Snyder, 15

NATIONAL SECURITY COUNCIL
WASHINGTON, D.C. 20506

March 14, 1983

MEMORANDUM FOR THE HONORABLE DONALD T. REGAN
The Secretary of the Treasury

SUBJECT: Publication of Article on Exchange Participation Notes

I am told that you were upset at the publication by the CSIS of the article about EPN's by myself, Robinson and Luft. If this is so, I apologize as I, of course, would not have published it had I thought you would be opposed. I felt justified in doing so, however, for the following reasons:

(1) Authorization was solicited at every step of the way, almost obsessively so, as can be documented.

(2) The idea had already been published, two months ago, and commented on in Business Week, The Economist, and The Wall Street Journal. The CSIS article is simply an expansion and elucidation so that at least the idea can be discussed in a meaningful fashion.

(3) Strong disclaimers were included in the article -- stating first that these were personal views only, and secondly, that the idea was a "straw man" designed to stimulate discussion only.

(4) It is an idea for a segment of the private debt only. It has nothing to do with the official debt reschedulings and rescues, which are being carried out with great skill and effectiveness. If, however, the financial crisis is predominantly structural and not predominantly a temporary liquidity shortage (which will be clear in 6-8 months) as we, Felix Rohatyn, Peter Kenen, Rimmer de Vries and others believe, alternatives to repudiation or long-term moratorium will be most welcome.

If that is not the case, as we all fervently hope, what harm has been done?

Norman

Norman A. Bailey
Senior Director
National Security Planning

cc: ~~William P. Clark~~
Roger Robinson

16

Memorandum

ACTION BRIEFING INFORMATION

FOR: Marc E. Leland

DATE:

Sent

FROM: Thomas B.C. Leddy

SUBJECT: Report of Working Group on Alternatives for Dealing with LDC Debt Situation

In Tom Dawson's absence, I am forwarding to you the report of the working Group on Alternatives for Dealing with LDC Debt Situation. This report is not the final product of the working group since the authors of some of the papers were unable to meet the deadline for providing revised drafts. In addition, the working group has not cleared the introductory section of the report, pending another meeting when Tom returns from Latin America. The working group also may agree at that meeting to undertake the additional analysis referred to in the introductory section, although at this point that is beyond the terms of reference for that working group.

Finally, some additional papers may be prepared dealing with, for example, proposals for SDR allocations or proposals for bank lending to the IMF for on-lending to LDCs, etc. Your concern about inclusion of a proposal for a rediscount facility is addressed by the paper entitled "Large Scale Debt Restructuring."

Attachments

	INITIATOR	REVIEWER	REVIEWER	REVIEWER	REVIEWER	SECRETARIA
CODE SURNAME	Bradley					
INITIALS / DATE	PB / 3/30/83	/	/	/	/	/

Report of IG-IEP Working Group on Alternatives for Dealing with LDC Debt Situation

Serious financing and adjustment problems now facing a growing number of countries have raised concerns that the strains on the international economic and financial system may develop into a major, disruptive crisis. In this context a strategy has been developed for dealing with the LDC debt problem. That strategy has several key elements, including

-- an increase in IMF resources to assure availability of official balance of payments support within the context of domestic economic adjustment;

-- availability of short-term "bridging" support by Central Banks and Treasuries;

-- maintenance of commercial bank lending; and

-- credible economic expansion in the U.S., Europe, and Japan.

There is broad consensus that this is the correct initial strategy, and that in fact it may be fully adequate to weather the current debt crisis. Concerns have been raised, however, about the potential inadequacy of this strategy should one or more element of the strategy break down, e.g., if the expected upturn in world economic recovery does not develop with sufficient vigor to assist LDC recovery, or if commercial banks are unwilling or unable to provide the level of financing envisioned in IMF programs.

Concerns also have been expressed that the current financial crisis is, at least to a substantial extent, structural in nature. The measures being taken to maintain international liquidity, therefore, if not coupled with other measures designed to address the structural deformities, may serve to exacerbate, not alleviate, the crisis by adding to the short-term burdens of the debtors and the risk exposure of the creditors.

It is within this two-pronged context that a number of proposals have surfaced, either officially or unofficially, for dealing with the LDC debt situation. These proposals can be grouped according to the problems they are meant to address: those that deal with the immediate crisis, should the exisitng strategy fail; and those that would address longer-term structural deficiencies. Although the proposals vary considerably in terms of advantages and disadvantages, they should be evaluated against some common standards, such as:

-- magnitude of assistance to countries most in need;

-- impact on commercial banks;

-- administrative complexity; and

-- political complexity.

In addition, an evaluation of alternative proposals will depend on an evaluation of the need for alternatives, based on judgments about the severity of the debt crisis and an assessment of the adequacy of existing mechanisms as detailed in the debt strategy paper. This paper does not attempt to make such an evaluation, but rather describes and analyzes some of the various proposals which have been circulated, as a means of providing background for use in the broader analysis of the LDC debt situation.

The proposals are grouped according to the problem they address, i.e., short-term liquidity problem or longer-term structural problem. This report addresses the major proposals that have been made; it does not purport to be all-inclusive. The proposals included in this report are:

<u>Short-term</u>

One-year Debt Moratorium
  a) On public debt
  b) On private debt

Retroactive Terms Adjustment

Large-Scale Debt Restructuring

Buyout of Small Creditors

<u>Longer-term</u>

Exchange Participation Notes

Developing Country Debt Corporation

Safety Net for Commercial Banks

Debt Commission

Secondary Market

One-Year Grace on 1983 Public Debt

Proposal: Debt service due in 1983 would be given a grace period and converted to a balloon payment with maturity in the fifth year (1989).

Description: Service on public debt, both interest and principal, due in 1983 would be given a grace period with a balloon payment in the fifth year (1989). Debt service due in 1984 would be paid as scheduled though if the economic recovery took longer than expected it too could be ballooned to 1990. This approach provides a year for conditions to return to normal and for some adjustment to take place. It would treat every country equally.

One variation of this proposal was made by the CSIS (Georgetown Center for Strategic and International Studies) and called for conversion of short-term bank debt to a long-term "massive renegotiation of oustanding indebtedness which spreads existing debt out farther into the future, reduces the annual debt service burden, and evens out the budging of maturities". Another variation is a proposed 5-year debt moratorium on principal and interest combined with trade and economic policy initiatives.

Analysis: Advocates of this proposal find an appeal in its structured, uniform approach to the world's debt problems and argue that it gives more certainty to the international financial community than do current ad hoc measures. They also like its intention to treat every country equally with its apparent ease of implementation.

One difficulty with the proposal is that substantial recovery in LDC exports is unlikely in 1983 and may not occur in 1984 either. Since the proposal does not require that the LDCs undertake any adjustment measures, it may simply postpone the problem without providing a solution. An equally serious deficiency of the proposal is that it presumes incorrectly that all debtors are having a problem. In actuality, some countries require generous debt relief while others require little or none. Once the proposal is modified to take these varying needs into account and individual countries are required to adopt adjustment measures, the proposal looks very much like the current Paris Club approach.

It is also far from clear that the idea is as simple as its proponents argue. Providing across the board relief on public debt service would require difficult negotiations between creditor nations, and even if agreement could be reached it would likely not occur until long after much of the problem would have been handled by current ad hoc procedures (and after most of the 1983 debt service had been rescheduled or paid). In addition, there is always the danger that collective treatment of debtors by creditors is likely to result in collective treatment of creditor by debtors, increasing the debtors' leverage and raising the possibility of coordinated repudiation. Finally, an across the board 5-year debt moratorium on principal and interest would be viewed as a giveaway by Congress and could jeopardize other assistance programs.

21

Proposal Postponement of Debt Service Payments Due in 1983 to Private Lenders

Purpose

This proposal, like its companion covering debt service to official lenders, would be aimed at providing "breathing space" to eligible developing countries while they formulated and implemented adjustment policies -- i.e., alleviating the burden of adjustment.

Description

(a) Consolidation Period. January 1 to December 31, 1983.

(b) Terms. Substantial grace period of, say, five years (alternatively, grace period could vary among debtor countries). Balloon repayment (alternatively, repayment over a specified number of years after expiration of grace period).

(c) Country Eligibility. While the proposal could be applied globally to all countries qualifying as "developing," it could be targeted more specifically. The criteria chosen would presumably reflect both need of the country and its adoption of a sound economic program. Being in good standing on an upper tranche standby agreement with the IMF is one possibility.

(d) Creditors Covered. Commercial banks hold most of the debt owed to private lenders. Also, they generally are the only private creditor group in a position to reschedule since others (bondholders, suppliers) are a more diverse group -- less able to cope with the legal and administrative complications -- and less familiar with the balance of payments considerations which govern both the need for a rescheduling and the likelihood of its success. Accordingly, the proposal would probably have to be confined to bank credits. Naturally, it would not apply to credits guaranteed by governments; these would be covered by whatever parallel arrangement applied to official lenders (see separate paper).

(e) Obligors Covered. The proposal could cover all obligors in eligible countries deemed to have "country risk" (i.e., excluding entrepot entities such as shipping companies registered in Liberia) or be confined to debt which is owed or guaranteed by the public sector (public debt). (Public debt constitutes roughly half of the total debt owed to banks by residents of developing countries.) It would be easier to compile data and negotiate terms on the public portion.

22

But there may be reasons to avoid differential treatment.

(f) Payments Covered. A key question is whether both interest and principal would be covered, or just principal. The tricky question of interest might best be left open, to be determined according to assessment of total relief required from this scheme when and if implemented, by specifying that a certain percentage of interest payments (to be determined on a case by case basis -- ranging from zero to 100%) would be covered.

(g) Maturity Covered. Either with or without short-term debt. Inclusion of short-term debt seems unavoidable (and would avoid the problem or original vs. residual maturity), given the high proportion it constitutes of total debt to banks.

(h) Compelling Banks' Participation. Most countries would be unable or unwilling to require their banks to participate in a scheme to concede grace on debt service. It would have to be organized by the banking community, e.g., by the newly established Institute of International Finance (Ditchley Group). Impetus could be given, however, if official creditors imposed the standard "comparability" condition on (presumed) parallel relief they granted or if the IMF predicated its assistance on the borrowing country's obtaining a specified relief from private creditors. Of course banks would insist on participation by all banks, and could try to involve nonbank creditors as well -- see (d) above.

Analysis

Insofar as it pertains to principal repayments, this scheme would in essence codify and give official blessing to methods now being employed on an *ad hoc* basis. The debtor countries cannot make net repayments on their foreign debt (no country in current account deficit can do so unless it has an abundance of reserves or can attract unusually large volumes of direct investment).

In good times the borrower has no difficulty in obtaining sufficient new credit to roll over maturing principal and net additional funds that can be used to finance the current account deficit, which includes net interest payments. In difficult times the banks not only resist extending net new credits but may also try to reduce existing claims -- a logical and justifiable attitude from the narrow perspective of the individual bank, but one which is of the "beggar-thy-neighbor" variety and not possible for banks in the aggregate. A rescheduling deals with this problem by ensuring that all banks postpone a given percentage of principal (up to 100 percent), normally covering a single year but possibly covering payments due over a longer period.

23

In recent cases, banks have agreed as well to extend additional credits. In two cases (Poland and Costa Rica) the amount of new money was determined as a percentage of interest payments received, and banks have agreed to lend Sudan enough to eliminate interest arrears and to postpone part of interest due in 1983. Banks are normally very reluctant, however, to establish a direct link between new lending and interest payments due them (i.e., "capitalizing" interest -- generally deemed to be an imprudent banking practice).

Since this proposal does not involve much of a change from existing practices or require a new institution, it has clear advantage over most other proposals. On the other hand, if its only effect is to reduce uncertainty as to how difficulties are to be handled, it could raise expectations and thus reduce incentive for LDCs to make fundamental adjustments, as well as imposing some rigidities which are avoided by the current ad hoc approach. These considerations are listed in the itemized pros and cons below.

Pros

1. Does not differ substantively from what is now being done on case-by-case basis (in fact, terms of typical reschedulings now provide perhaps four years for repayment -- although after three rather than five years of grace).

2. Diminishes uncertainty to the financial community as to how liquidity problems will be handled.

3. Could be implemented more quickly than proposals involving establishment of new institutions.

4. Relatively simple in concept (although decisions on country eligibility, coverage, etc., would be difficult to agree on).

5. Would deflect domestic pressure in debtor countries for unilateral action.

Cons

1. As a fixed formula, would provide more relief than many countries need and less than many others need, although criteria for participation could resolve this problem. Particularly unlikely to provide meaningful amounts to LDCs with liquidity difficulties if restricted to certain debts, or if interest is not covered, unless applied in conjunction with other programs.

2. Establishes precedent for similar relief in future years.

3. Likely to discourage banks from undertaking additional

24

new lending in 1983 since they would argue that they had done what was asked, and may result in lower lending beyond 1983 due to perception of greater risk.

4. (If interest is included) would raise many problems for banks, and regulators. It would be difficult to justify accruing postponed interest (i.e., recognizing it as income), and widespread non-accrual could cause losses sufficient in magnitude to undermine perceived strength of some banks involved.

5. Failure to tie country eligibility to upper tranche IMF program or comparable criteria would dilute ability to direct assistance where needed and to induce appropriate adjustment.

6. Although not very different from existing practices on an ad hoc basis, most governments have no means to compell their banks' participation. As a result, it would be extremely difficult to negotiate with other governments safeguards that would ensure participation by all banks on terms that would neither be, nor seen to be, a "bail-out" by official lenders.

7. Allows debtors to negotiate collectively, thereby increasing their leverage.

Analysis

of

Retroactive Terms Adjustment

Proposal: The United States should begin to implement Retroactive Terms Adjustment as authorized under the Foreign Assistance Act of 1961 as amended.

Background

In March 1978, the Trade and Development Board of UNCTAD adopted, with U.S. concurrence, a resolution stating that "developed donor countries will seek to adopt measures for adjustment of terms of past bilateral official development assistance, or other equivalent measures." In effect, the proposal has come to mean debt forgiveness for the poorest nations.

To implement the UNCTAD Resolution on Retroactive Terms Adjustment (RTA), Congress amended the Foreign Assistance Act of 1961, Section 124(c), which provided that "prior assistance terms should be consistent with present grant assistance for relatively least developed countries.... Therefore, the President on a case-by-case basis may permit a relatively least developed country to place amounts which would otherwise be paid to the United States as payments on principal and interest on liability incurred by that country into local currency accounts for use by the relatively least developed country, with the concurrence of the Administrator of the agency primarily responsible for administering this part, for activities which are consistent with section 102." The President also may waive interest payments owed by a relatively least developed country if he determines that the country would be unable to use for development purposes the equivalent amounts of local currencies.

26

U.S. legislation does not give authorization for a blanket write-off of debt. Rather, it allows conversion of principal and interest owed for a specific year by a specific country for use in development projects approved by the AID Administrator.

U.S. Implementation of RTA

The implementation of Sec. 124(c) requires that the Administration include in its annual budget request the amount to be converted to local currency. This amount must be authorized and appropriated by Congress. For FY 1980, the Administration requested $10,845,000 which passed all committees but was dropped in conference. For FY 1981 the Carter Administration requested $18.8 million, but this was dropped under the Reagan budget revision. There have been no requests in the past two years.

Of the 29 countries on the UN list of countries identified (in 1976) as least developed, the Carter Administration proposed in both requests that 14 receive the benefits of RTA. (Eighteen of the 29 countries had outstanding debt service owed to the U.S. of $420.9 million in FY 1982). The 14 were: Bangladesh, Benin, Botswana, Guinea, Haiti, Malawi, Mali, Nepal, Niger, Somalia, Sudan, Tanzania, Uganda, and the Yemen Arab Republic. (See attachment for table on debt and debt service.) Others not included were eliminated for political reasons (e.g., Ethopia, Democratic Yemen) or did not have debt liabilities owed to the United States. AID estimates that debt servicing owed by the fourteen countries to the United States subject to RTA conversion would be as follows:

FY 1983 -	$11.6 million
FY 1984 -	12.7 million
FY 1985 -	14.4 million
FY 1986 -	15.3 million
	$64.0 million

Therefore, implementation of RTA, as provided for in the Foreign Assistance Act, would be relatively simple, inexpensive, and would be compatible with bilateral considerations and needs.

Pros

1. Implementation of RTA directly meets the U.S. international commitment.

2. Implementation of RTA would conform to the present U.S. policy of providing only grants to the least developed countries.

3. The legislation allows for selective consideration of countries based on need and foreign policy/political relationships (e.g., for Sudan). In addition, countries would not have to be included in RTA actions every year.

4. Implementation is relatively inexpensive and for FY 1986 would cost $15 million for fourteen countries.

5. The use of local currency resulting from RTA would require the AID Administrator's concurrence and thus allows U.S. control on these resources.

6. Such action would give the United States international political mileage at relatively little cost. It could have a positive psychological effect on "doing something" about debt and the U.S. leadership role.

7. RTA-backed development projects could still be open to U.S. procurement opportunities thus expanding U.S. exports.

8. Implementation now of retroactive terms adjustment (RTA) could take some of the steam out of a building UNCTAD issue that could be too heated by Spring to resolve reasonably to our satisfaction. It also would be responsive to the Brandt II report.

Cons

1. The U.S. has sufficiently met its international obligations as stated in the phrase "or other equivalent measures" by extending assistance only on a grant basis to the least developed countries.

2. During a recession period and tight budget situation, the U.S. public may not endorse converting U.S. aid assets to grants.

3. Any request for RTA budget authority may be taken at the expense of other AID budget items.

4. The debt rescheduling process, supplemented by moderate amounts of new lending in support of sound economic programs, are the appropriate procedures for correcting debt-servicing difficulties.

5. The program is a permanent loss in revenue, albeit small.

6. The requirement for annual requests to Congress keeps the program in the political spotlight (although AID budget requests face traditional opponents on the Hill annually).

7. It is largely a symbolic gesture which fails to address the larger problem.

Debt Data for Proposed RTA Recipients*

(U.S. $ Millions)

Country	Total Debt[a]	Interest Payments	Total Debt Service			Debt-Service Ratio[b]	
			1981	1982	1984	1980	1981
Bangladesh	6,137.8	46.3	97.9	135.5	209.5	5.6	6.9
Benin	718.0	9.6	21.8	51.0	78.4	.6	2.2
Botswana	310.0	6.7	8.7	25.9	31.1	1.7	1.4
Guinea[c]	1,620.9	21.8	82.6	131.0	126.1	6.1	5.3
Haiti	463.9	6.0	20.0	12.5	21.4	3.9	5.4
Malawi	867.3	50.3	88.7	114.6	95.0	4.5	5.4
Mali	830.8	6.8	36.5	39.8	61.8	1.3	2.9
Nepal	650.3	2.6	4.9	6.0	10.5	1.5	1.6
Niger[c]	915.3	33.8	63.1	105.8	104.7	2.2	3.8
Somalia	1,316.0	3.6	16.1	64.5	86.7	3.5	6.1
Sudan	6,004.1	29.2	110.7	685.4	751.6	7.2	-
Tanzania	2,341.1	34.4	107.1	95.3	137.8	7.2	-
Uganda	779.9	10.4	50.3	122.2	50.8	4.2	-
Yeman Arab Republic	1,746.9	10.0	58.7	66.8	104.7	1.1	4.6

*World Debt Tables, World Bank, February 1983.

a. Public/publicly guaranteed medium and long-term external debt outstanding including undisbursed.
b. Total debt service as a percent of exports of goods and all services.
c. Total debt service as a percent of gross national product.

Large Scale Debt Restructuring

Proposal

Several public proposals have called for a comprehensive restructuring of LDC debt. There are two basic elements in these proposals.

-- Buyout of debt: A new international institution replaces the banks, in whole or in part, as the creditor of LDCs. In place of claims on the LDCs, the banks receive claims on this new institution. These claims have a face value less than that of the LDC debt they replace, but are secure assets because debts of the new intermediary are guaranteed by Western governments. The new institution might be organized under the aegis of the IMF or the World Bank.

-- Rescheduling: Once the new institution has taken over as the principal creditor of LDCs, it reschedules their debt into longer-term claims at reduced interest rates.

Description

Debt restructuring plans are meant to serve two purposes. The first is to insulate the financial system from the risk of disruption due to declaration of a debt moratorium or repudiation by one or more debtors. Since the banks would no longer hold direct claims on the countries, such an event would no longer threaten to provoke a banking panic or drive any banks into insolvency -- although it would impose substantial costs on the governments which guarantee the institution's debt.

The second purpose is to overcome the problem of coordination in rescheduling. By replacing a number of banks with a single official creditor, the plans could help overcome the "free rider" problems which have made rescheduling difficult to achieve, e.g., the efforts of regional banks to reduce their exposure.

None of the proposals has been fully developed. The most detailed is a proposal by Peter Kenen, of the Group of Thirty, which can serve as a reference point.

Kenen's plan calls for the creation of a new institution, the International Debt Discount Corporation (IDDC). This corporation would have some capital subscribed by developed country governments.

The IDDC would issue long-term bonds to banks in exchange for the debts of LDCs, at a discount of perhaps 10 percent. It would then reschedule LDC debts into longer term claims, using part of the 10 percent extracted from banks to provide debt relief in the form of lower interest rates or grace periods.

The operations of the IDDC would be subject to the following limitations:

(i) The IDDC would deal only with countries which recognized it as successor claimant to the banks;

(ii) It would limit its activities to countries which have agreed on an IMF-sponsored stabilization program;

(iii) The IDDC would accept only debts which are either direct claims on governments or guaranteed by governments;

32

(iv) Debt which is already guaranteed by developed countries would not be accepted (a restriction designed to exclude much of the European lending to Poland).

(v) Banks would not be allowed to choose which debts to discount: if a bank wanted to discount 60 percent of its claims on LDCs doing business with the IDDC, it would be required to discount 60 percent of its claims on each country.

(vi) The IDDC would not operate on a continuing basis, allowing banks to choose when to discount their claims: it would make a one-time offer.

(vii) Finally, the IDDC would not tailor its rescheduling to individual countries. Instead, it would offer a standard rescheduling package.

An alternative plan has been proposed by Felix Rohatyn of Lazard Freres. In Rohatyn's plan, as in Kenen's, an intermediary would be created, perhaps within the IMF or the World Bank. This new intermediary would replace banks as the claimant on LDCs, and banks would receive long-term bonds guaranteed by Western governments. The principal difference from the Kenen proposal is that Rohatyn calls for a large write-down on the debt in the form of strongly concessional interest rates: twenty-five year debt at 6 percent was suggested. He also suggests that countries dedicate some sources of foreign exchange to debt service.

Pros

-- Reduced Risk to Financial System: Banks would no longer be at risk from failure of countries to pay, because that risk would be assumed by Western governments. Thus the danger that LDC debt problems could lead to a financial system collapse would be removed.

-- Improved coordination: Buying out the banks, especially small creditors, might make rescheduling much easier to accomplish.

Cons

-- Bailout of Banks: Unless the LDC debt is acquired at a substantial discount, a debt restructuring could appear to be a bailout of banks, creating political difficulties now and encouraging irresponsible lending in the future. The appearance of a bailout could be particuarly strong if a debtor country should in fact fail to pay its debts and Western governments end up making up the difference. Given the difficulty in obtaining Congressional approval of quota increases and multilateral development bank replenishments, it is hard to believe that Congress would agree to what would appear to be a massive bail-out of commercial banks and less-developed countries.

-- Bailout of Countries: To the extent that the restructuring involves concessional interest rates or other debt relief, it might appear to be a bailout of countries from the consequences of irresponsible policies. It is also arguable

34

that once an international agency has become the major creditor of LDCs it will be difficult to avoid a progressive shift to more concessional terms. As with a bailout of banks, this could both raise political difficulties and encourage irresponsible behavior in the future.

-- <u>Premature Forcing of the Issue</u>: A final objection to a debt restructuring plan is that it could force a writedown of bank debt at a time when there remains a reasonable possiblity that no writedown will prove necessary. If banks are forced into a premature writedown the effect would be the opposite of a bailout, and future lending would be discouraged.

Buyout of Small Creditors

Proposal

An official buyout of small creditors of LDCs could ease the refinancing problem by reducing the number of parties at debt rescheduling negotiations, and at refinancing negotiations. If official sources were to take the place of regional banks anxious to withdraw, the larger banks would not have to pick up the regional bank share and would avoid increasing their exposure as much as they have had to in the most recent refinancing.

Description

The basic mechanism of a small creditor buyout would be the following: an official loan would be made to a debtor country for the express purpose of repaying small creditors. This loan might be provided in a variety of ways; a special SDR allocation seems a likely candidate. The buyout would then proceed according to some rule. There appear to be two main options for the rule:

1. Buy out all creditors below some maximum size. E.g., all banks with less than $10 million exposure in a country might be bought out.

2. Buy out a maximum amount of any creditors' claims. E.g., any creditor can sell off $10 million in debt.

The second option would require a larger official loan, but would avoid some pecularities, such as refusing a buyout to banks just above the size limit.

Pros

-- Reducing "Free Rider" Problems: By eliminating small creditors, a buyout would leave a more concentrated group which would be able to better coordinate refinancing and rescheduling.

-- Limiting Exposure of Large Banks: Major creditors would not be required to increase further their share in LDC debt. This would help limit the risks to the financial position of these banks, and thus to the financial system as a whole.

Cons

-- Increased Official Involvement:

A buyout would increase the official role in the refinancing process. This is undesirable in general and is particularly troublesome given the political opposition to anything resembling a bank bailout.

-- Incentives for Excessive Lending: The precedent of a buyout of small creditors could encourage irresponsible lending by small banks in the future. In the case of Mexico, heavy lending by U.S. regionals was an important factor in the 1980-81 debt explosion.

Exchange Participation Notes

Proposal

As a substitute for principal repayments on unofficial balance of payments loans, central banks of "qualifying" debtor countries would issue Exchange Participation Notes (EPN). These Notes would be negotiable debt instruments with repayment tied to the debtor country's future foreign exchange earnings.

Description and Purpose

In lieu of principal payments on outstanding balance of payments loans, creditors would receive Exchange Participation Notes, which would provide them proportional rights (based on amount of credit outstanding) to some agreed percentage of gross annual current account foreign exchange receipts. Interest payments on this "converted" debt would be maintained in accordance with the original loan documentation, or it could be assigned to the holder of the EPN, or combined with principal in the EPN itself. To qualify for issuance of EPNs a country would be required to have structural financial problems serious enough to justify an IMF extended fund facility program and to have one in place.

The central banks of the debtor countries would accept responsibility for redeeming EPNs and would also act as collection and paying agents. The resources and activities of the BIS, IMF, and creditor central banks would be directed primarily to keeping the debtors' interest payments current. If necessary, some percentage of the interest paid to commercial lenders could be re-extended to the borrowers as short-term trade credits.

The purpose of this proposal, according to its authors,1/ is to correct perceived distortions in the international financial system caused by recent worldwide economic events, and to prevent the transformation of the international financial system from "an engine of growth to a system designed mainly to support current debt levels."

That is, in recent years increasing amounts of credit have been extended for purposes unrelated to those purported in the loan documentation, or with no secure means of repayment. For example, two or even three year money has been provided for commodity imports -- in essence a disguised form of balance of payments financing. Likewise, creditors once channeled funds into capital-forming enterprises, particularly export industries, which, in turn, would generate sufficient hard currency earnings to amortize the respective maturity schedules. These same creditors now lend money for unstructured balance of payments loans.

1/ Norman Bailey, R. David Luft, and Roger Robinson

38

Despite the disparity in repayment prospects, private sector debt reschedulings have been based on the premise that all creditors receive equal or pari pasu treatment. The authors of the EPN proposal find this inappropriate and believe that project loans -- where earnings from the project are dedicated to loan repayment and lenders have control over a collateralized account -- and loans secured by assets, should be excluded from a rescheduling, or at least rescheduled on terms separate from balance of payments loans. The issuance of Exchange Participation Notes would apply, therefore, only to unofficial balance of payments loans.

Analysis

Exchange Participation Notes are not designed as a cure-all for solving LDC debt problems. They only would be issued to private creditors who had extended balance of payments loans. In this sense EPNs alone would not solve the refinancing problem. In conjunction with official debt rescheduling, however, a system of EPNs may have advantages which make it worth exploring.

The principal advantage of EPNs presumably would be that such a system would provide incentives to expand world trade and to support the economic adjustment programs of financially troubled countries. That is, holders of EPNs would find it to their advantage to continue to lend to countries who have issued EPNs in order to increase or guarantee the return on the EPNs. One problem with this rationale may be that there is no evidence that a system of EPNs would encourage the "fringe" or regional banks to maintain lending levels anymore than does the current system. Even under a system of EPNs a regional bank could decide that so long as the bigger, money center banks maintain lending levels, all holders of EPNs will benefit. There would be no reason for a particular bank to maintain its lending levels. In the aggregate, however, banks would be better off by keeping credit lines open and encouraging the expansion of trade, since the return on EPNs is so directly linked to foreign exchange receipts.

The authors of this proposal argue that another advantage of EPNs is that banks would be able to replace questionable assets -- rescheduled loans -- with more negotiable ones and, in many cases, reduce or avoid the necessity of providing for losses. That EPNs would be negotiable is open to question, and in any case they probably would be so only at a discount since they would represent a claim on a country which was admitedly experiencing balance of payments difficulties. As such, bank examiners and auditors may also value EPNs at less than face value, and banks would have to take some losses on loans which were "converted" to Exchange Participation Notes.

39

A system of EPNs would be a more overt system of restructuring bank debt to LDCs, however, and would in that sense by a more honest system than the current practice of carrying rescheduled loans as short-term assets, even though the liquidity of those assets is far from short-term. In this context a system of EPNs is quite consistent with current Congressional interest in more and better commercial bank disclosure of indebtedness to developing countries.

The most interesting aspect of the EPN proposal is the premise of payment according to the borrower's ability to pay rather than according to the cost of funds and risk incurred by the lender. While in one sense this concept runs contrary to the principles of commercial banking, in another sense it is a more rational way of collecting on overdue debts, i.e., in a good year the debtor pays more and in a bad year the debtor pays less. In addition, once procedural and bureaucratic mechanisms are in place, payments are automatic, thus avoiding the time and expense of annual debt rescheduling exercises which ultimately also are based on the debtor's projected ability to pay.

One problems with this proposal, of course, would be the temptation for a country to under report its foreign exchange receipts. For example, certain trade accounts might be kept on a non-cash or barter basis in order to keep export receipts artificially low. At a minimum the EPN proposal would require maintenance of a complete and accurate data base, to be monitored by an objective third party such as the IMF or World Bank.

Once the percentage of foreign exchange receipts to be paid was agreed, debtor countries also may have less incentive to allocate domestic resources toward production of export goods, since increasing exports would directly increase debt service payments. While this may be a short-sighted policy for a debtor country to pursue, it is related to the question of a country's willingness or political ability to explicitly mortgage foreign exchange receipts to foreign creditors.

Finally, the complexity of implementing a system of Exchange Participation Notes makes it doubtful that it could be negotiated successfully. The advantages of such a system would have to be sufficiently attractive to make the negotiations worth the effort they would require.

ANALYSIS OF THE
DEVELOPING-COUNTRY DEBT CORPORATION

Issue: A quasi-public institution, the Developing-Country Debt Corporation, should be established which would sell debt paper and guarantee debt-servicing to private/institutional investors.

Proposal: After the debt crisis subsides, an institution should be created that supports creditworthy commercial lending to developing countries and helps ensure that borrowing needs (e.g., maturities) are matched with prudential lending principles. This concept would not be designed to correct questionable lending or support countries that are in difficult debt-servicing straits. Rather, it is envisioned as a secondary market device designed for "healthy" borrowers and an enhancement to the strength of the international financial system.

Under this proposal, the Developing-Country Debt Corporation, a quasi-public institution, would buy commercial paper for developing-country loans from private banks. Such paper would have to qualify to specific creditworthiness standards that would be developed by the Corporation's Board of Directors. The Corporation would then offer the paper to longer term investors with a guarantee at a lower than market rate. (With the guarantee, less risk is involved and thus the rate would decline from market levels.) The guarantee could cover any proportion of the loan, i.e., 100 percent, 50 percent, 30 percent. The developing country would then pay debt-servicing obligations to the Corporation at a longer maturity and lower interest. The investor would be backed in whole or part, by the Corporation's guarantee. This device would better enable borrowers to match maturities with project needs and would offer more attractive interest rates.

The Corporation would require initial capitalization from creditor countries, but would operate on a self-sustaining basis (similar to the Overseas Private Investment Corporation). The contributions would be repaid from profits in a manner determined by the Corporation's charter.

Background: A number of secondary market proposals have surfaced which are variations of the above proposal. Governor Wallich has proposed that commercial banks package developing-country loans (much as a bank might do for mortgages) for sale much as investment banks might do. The question arises why investment bankers are not already packaging such loans. What is needed is a guarantee to make such transaction more secure and acceptable.

Other secondary market proposals, such as the commercial-debt rediscount facility, would not necessarily meet the maturity issue of matching bank liabilities and assets, and at the same time meet project loan needs of the borrowers. World Bank cofinancing operations, for example, resolve this by having private lenders take the shorter-term portion of loans and the World Bank takes the longer-term risk.

Pros:

1. The Debt Corporation would allow improved distribution of risk and less concentration among private lenders.

2. The Corporation would better match commercial resources to developing-country financing needs, i.e., maturity and interest rates.

3. Such a facility would encourage continued capital flows to developing countries.

4. Creditworthiness standards and guidelines would be developed and enforced.

5. The secondary market institution would be self-supporting after initial start-up funding.

6. The facility would add greater confidence to the international financial system.

Cons:

1. There may be some objections by governments to establishing another institution (or facility within the World Bank or IMF).

43

2. There may be objections to participating in the facility's initial capitalization.

3. As the debt obligations would have to meet creditworthy standards and would have to be competitively priced, it is unlikely that the countries most in need would be eligible.

44

Proposal Establish a "Safety Net" for Commercial Banks

Purpose

Banks have curtailed new lending to developing countries because of a perceived increase in risk. This proposal is intended to reduce the perceived risk by diversifying it: banks would contribute a small percentage of the amount of the loan to a central fund and draw on the fund if the loan went bad and they encountered "financial difficulties."

Description

(a) Institutional Framework. A new institution would probably have to be created. If an official entity, it could be placed within an existing institution (e.g., the Trust Fund within the IMF). Such an institution could be endowed with decision-making powers, or could be a forum for coordinating uniform (but separate) implementation by individual governments and central banks of an agreed set of guidelines. If created voluntarily by private banks, it would have to work closely with international institutions and national authorities.

(b) Eligible Loans. While all sovereign risk loans could be covered, the scheme might be applied only to certain categories. It would probably be necessary to exclude lending to the foreign private sector since it might be difficult to determine whether non-payment was due to commercial causes or to the inability/refusal of the authorities to provide foreign exchange. Short-term credits perhaps should also be excluded, since the cost could be prohibitive.

(c) Terms of Contribution. Banks would contribute an established percentage of each eligible loan to the central fund at the time of disbursement. In principle, the borrower would not be paying a higher rate on the borrowing, since the bank's payment would represent an insurance, i.e., risk, premium that would be reflected in the standard terms on loans to that borrower.

(d) Recourse to the Central Fund. Payments from the central fund would be made to banks that encountered "financial difficulties" as a result of debt servicing problems on loans against which they had made a contribution to the fund. That is, the emergence of arrears would be a necessary but not a sufficient condition to trigger payments. "Financial difficulties" could be defined as arrearages of a certain magnitude or as liquidity problems (which would arise because market perception of weakness due to losses resulted in sharp tiering or total exclusion of the bank from the deposit and money market).

45

(e) Official Support to the Central Fund. To be credible, the central fund might require some assurance of support from governments if its own resources were inadequate to meet calls on it. If the triggering condition were liquidity problems of the nature that central banks traditionally are prepared to respond to, lines of credit from central banks are conceivable. More likely, though, official support would have to be available in the form of callable capital. Official support would of course only be relevant if the central fund were an official entity.

Analysis

This proposal is somewhat similar to various insurance and guarantee schemes that have been advanced over the years, particularly to meet perceived "recycling" problems. A number of these were examined by the IMF/IBRD Development Committee's Task Force on Non-Concessional Flows. Some time was spent discussing the merits of a new mechanism (a Multilateral Partial Guarantee Framework) drawing on the various schemes proposed. The Task Force, after conducting a seminar with representatives of private banks, did not reach a conclusion on the MPGF, recommending only that future consideration of guarantees reflect certain principles (see pp. 33-36 of May, 1982 Report) such as the desirability of guaranteeing only later maturities.

A suggestion by World Bank President Clausen to explore creation of a Multilateral Investment Insurance Agency (see IBRD document R 82-225, July 14, 1982) also entails certain similarities. However, it pertains to direct investment rather than bank lending.

It is difficult to appraise the proposal without a firm idea of what it would involve. The potential advantages consist essentially of increasing confidence in the system, but the likely impact cannot be easily determined. The disadvantages lie in the complexity of negotiating an arrangement and its political unattractiveness in view of opposition to bank "bailout". Such a scheme could not be devised and implemented in time to be helpful during a crisis. These considerations are listed in the pros and cons below.

Pros

1) Would increase confidence among private financial institutions and markets; would supplement existing lender-of-last-resort understandings.

2) If established voluntarily by private banks, would avoid the major stumbling block posed by negotiation among governments and obtaining legislative approval.

46

3) Would sensitize banks to the risks involved in international lending and the need to have to carry out good economic analysis of borrowing countries.

Cons

1) Banks would not be likely to make their contributions out of profit margins. Rather, they would strive to offset the contributions by charging higher fees or wider spreads.

2) Questionable whether banks would actually make available more funds than in absence of scheme (additionality). Unlikely a partial guarantee on risky lending will lead to more lending. If additional funds were provided, could encourage LDCs to overborrow, postponing measuring adjustment.

3) Might have to apply to all or vast majority of banks in order to be effective, but compulsion via coordinated statutory or regulatory measures is probably not feasible. (N.B. If formed without official involvement, banks would not face official pressures. Also, if formed by governments, scheme would presumably be attractive since underlying conditions would be worse than now.)

4) Establishing and operating institutional framework is likely to be extremely complex, e.g.,

- specifying which loans are covered;
- assessing risk of particular loan and determining appropriate percentage of contribution to central fund (if the percentage did not vary to reflect different levels of risk, lending would be distorted);
- specifying conditions governing recourse to central fund;
- collecting contributions (and determining how interest on contributions is to be paid, if at all);
- establishing voting rights, if institution has decision-making powers.

5) Would probably require substantial callable capital (hence, authorization and appropriations), possibly substantial amounts, from governments.

47

Debt Commission

Proposal: Establishment of an international debt commission to monitor debt conditions, establish uniform criteria for debt rescheduling, and help prevent debt crises by encouraging appropriate advance actions.

Description: An international debt commission would be appointed by a neutral body such as the World Bank or the IMF with representatives from creditor and borrowing country governments, commercial banks and neutral bodies. The commision would monitor world debt conditions, help prevent debt crises by encouraging appropriate advance actions, and establish uniform criteria for debt rescheduling. From proposals made so far, it is not clear if the commision would actually manage debt rescheduling or simply provide criteria for the Paris Club.

The commission would work closely with the IMF, the World Bank and the Institute for International Finance. The latter is a private commercial bankers' plan, referred to as the Ditchley 2 Group, to establish a research organization to collect detailed informtion about the economies of debtor countries and their future borrowing plans.

Analysis: Advocates like the supposed neutrality of such a body and believe that it would help difuse calls from developing countries for more radical action.

The principal difficulty with the proposal would be the composition of the commission. As creditor and debtor countries would both want to influence its selection it would almost certainly lead to a North-South confrontation. A similar confrontation would also result from an attempt to ensure uniform criteria for debt rescheduling which in any event is inappropriate for countries facing greatly varying degrees of economic difficulty. Attempts to give uniform treatment would probably minimize conditionality and result in less than adequate adjustment for many countries.

Finally, it is not clear what the commission could accomplish that is not already being accomplished by other organizations. The World Bank already collects debt data, though it needs to do more, and the IMF already encourages appropriate advance actions by countries likely to run into serious financial trouble through its Article IV consultations. The Paris Club works to ensure uniform treatment of debt rescheduling, but it also flexible enough to make adjustments when needed.

48

Drafted: EB/IFD/OMA:GMaybarduk:jms
3/30/83 632-3024

Cleared: EB/IFD/OMA:WBMilam

A Secondary Market - A guaranteed secondary market for trade paper guaranteed both by national export credit insurers (e.g. FCIA domestically and MITI, COFACE, etc. abroad) and an international institution (i.e. IMF, BIS) would provide sufficient backing for the paper to be resold on capital markets. Banks would originate and authenticate the export paper, while the national credit insurers and the international guarantor would cover the political default risk.

The lack of sufficient trade finance can cause reductions in trade beyond what might have been planned as part of an adjustment program would have required under IMF programs. Countries seeing their access to these lines of credit being rundown have been forced to freeze repayments unilaterally. In some cases a stalemate has been reached -- banks are reluctant to provide new credits and countries are refusing to payback old loans without commitments to fresh funds. Often this situation does not reflect an inability to pay, but only a reluctance to allow banks to desert a country in a time of need. The banks desire to cut and run reflects a lack of confidence which needs to be reestablished.

Providing a guarantee facility for short term trade paper would provide the confidence building measures required to maintain normal trade finance. A secondary market would provide a way for banks to reduce exposure in individual and the guarantee countries.

To some extent this proposal is similar to normal bankers acceptance markets except by providing the guarantees of an Ex-Im or it would increase marketability of the paper and allow for IMF pooling of impossible trade paper for resale.

Banks would continue to originate and authenticate the trade paper as well as process the transaction through normal letter of credit transaction. They would forward the rights to the proceeds of the sale to the international institution who would sell shares of a pool of 90 day paper or 120 day paper to investors. Upon maturation the bank would forward the proceeds to the BIS who would pay off or roll over an investors share. This packaging is similar to the way some banks handle mortage pools grouping together a number of mortages and selling pieces to investors.

The international institution or Ex-Im could guarantee only a portion of the paper to assure bank participation. Only that percentage of the paper that is guaranteed would be subject to sale on the secondary market.

Pros

- It would use private captial markets to assure adequate finance for normal commercial transactions. Barring a default, it would not bail out the banks or the LDCs - it would only be a confidence building guarantee facility that would be paid for by the banks and LDC companies.

- It would take the uncertainty out of an important part of LDCs' financing requirements and allow time for medium and long term packages to be assembled.

- A significant amount of bank liquidity could be freed up for other lending and it would reduce their exposure to individual countries.

- It would assure that essential imports reach debt-strapped LDCs and that their exports could be shipped in a timely fashion. This would prevent unnecessary contractions in trade flows and develop the climate for trade expansion that is neccessary for eventual debt repayment and for OECD recovery.

- It builds on similar guarantee mechanisms operating in many countries (i.e. FCIA) which do not now provide a secondary market and often do not operate in crisis situations.

<u>Cons</u>

- Establishing the facility would be difficult and complicated, to establish, particularly given the short-term nature of trade credits.

- Eligibility requirements might involve some political decisions regarding which countries would be allowed to use it.

- The BIS or IMF would resist taking on this role and a new facility might have to be developed.

- Banks may be unwilling to pay the premium for the guarantee and instead pass it on to LDCs.

- If default did occur the guarantee facility would be liable.

WITHDRAWAL SHEET

Ronald Reagan Library

Collection Name
Robinson, Roger: Files

Withdrawer
SRN 2/15/2012

File Folder
INTERNATIONAL FINANCIAL: 03/02/1983-03/31/1983

FOIA
F01-052/3
GRYGOWSKI

Box Number
3

20

ID	*Document Type* *Document Description*	*No of pages*	*Doc Date*	*Restrictions*
131214	MEMO NORMAN BAILEY TO WILLIAM CLARK RE: DEBT STRATEGY	2	3/31/1983	B1

The above documents were not referred for declassification review at time of processing

Freedom of Information Act - [5 U.S.C. 552(b)]

B-1 National security classified information [(b)(1) of the FOIA]
B-2 Release would disclose internal personnel rules and practices of an agency [(b)(2) of the FOIA]
B-3 Release would violate a Federal statute [(b)(3) of the FOIA]
B-4 Release would disclose trade secrets or confidential or financial information [(b)(4) of the FOIA]
B-6 Release would constitute a clearly unwarranted invasion of personal privacy [(b)(6) of the FOIA]
B-7 Release would disclose information compiled for law enforcement purposes [(b)(7) of the FOIA]
B-8 Release would disclose information concerning the regulation of financial institutions [(b)(8) of the FOIA]
B-9 Release would disclose geological or geophysical information concerning wells [(b)(9) of the FOIA]

C. Closed in accordance with restrictions contained in donor's deed of gift.