



May 9, 1988

Dear Colleague

It occurs to me that you would find it useful to know something further of our planning for the Third and Fourth Sherpa meetings in terms of their call on your time and schedules.

As outlined in my letter of 26 April, the Third Sherpa meeting in Paris will start on 19 May in the evening with a reception followed by separate dinners at the residence of the Canadian Ambassador in Paris. Sherpas would, if you agree, discuss recent developments and their relationship to the Summit. These would include the OECD Ministerial and other recent meetings as well as an indication from the French Sherpa of the likely priorities of the new French government. On May 20, plenary sessions at the Centre Kleber would be devoted to discussion of the thematic paper, while over lunch I believe Sherpas should discuss ancillary issues as well as the nature, length and number of Summit texts we would like to see come from the Toronto Summit. We will also provide a short update briefing on Summit logistics that afternoon. At dinner, once again at the residence of the Canadian Ambassador, we might engage in a tour de table on political issues. On the morning of 21 May, at Centre Kleber, we should attempt to sum up. I have made no plans for continuing this meeting over lunch as many of us will be anxious to return to our capitals as soon as possible.

As you will recall, after much consultation, we decided to stick to our original plan of holding the Fourth Sherpa meeting at the Millcroft Inn outside Toronto, June 3-5. Political Directors will meet in Toronto June 4 and join us for dinner that evening. My proposal for this last meeting would be that we tackle new developments at our dinner opening June 3, devote plenaries on June 4 to the main Summit economic text, with luncheon discussion among Sherpas given over to ancillary issues and other possible texts. That evening, with Political Directors, we would map out a strategy for addressing political issues at the Summit and discuss possible political Summit language. On June 5 we would sum up on economic issues in the morning plenary, and then, over lunch, revert to political issues among Sherpas alone to discuss how we might integrate our conclusions with the

Political Directors into Summit planning as a whole. Because of the inability of Political Directors to meet with Sherpas until 4 June, I fear that there is no way of avoiding a lunch among Sherpas on 5 June. In the afternoon we would propose a visit to the Toronto Summit sites, with departures for capitals in the early evening. I trust that these plans can be accommodated at this last, and most important, of our Sherpa meetings prior to the Toronto Summit.

For those returning to Europe, nearly all flights to Europe leave in the early evening so that members of our group who need to be at meetings in Luxembourg in the morning of 6 June should be able to get there on time (eg KLM flight KL692 departing Toronto 1725 arriving Amsterdam 0630 connects with flight WU205 departing Amsterdam 0850 and arriving Luxembourg 0955).

Please let me know if you foresee any problems with these scenarios for our meetings. I look forward to seeing you later this month in Paris.

Yours sincerely

SYLVIA OSTRY

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Principal Private Secretary
to the Prime Minister
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10 Downing Street
LONDON
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Canadian High Commission



Haut Commissariat du Canada

Ottawa, Ontario
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May 6, 1988

Dear Colleague

I am writing today to send you the thematic paper for our Third Sherpa meeting, in preparation for the Toronto Summit to be held in Paris, May 19-21. I leave further distribution of the paper in your capital to you.

Yours sincerely

SYLVIA OSTRY

Mr Nigel Wicks, CBE
Principal Private Secretary
to the Prime Minister
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THEMATIC PAPER

General

1. Too long (and turgid) to serve as a draft communique. But as in previous years will no doubt be a quarry for communique language.
2. Thematic paper does not cover 'ancillary' Summit economic issues - energy, environment etc.
3. See no need to submit to Ministers at this stage. Best left until after Third Sherpas meeting.
4. On the 'nature, length and number of Summit texts' (Mrs Ostry's letter of 9 May) we prefer one economic communique and one political communique that covers important issues discussed at the Summit and does not try to cover the whole field.

Detail

Para 1. Communique should not say that UK expansion exceeded potential growth.

Para 2. Communique should not dwell on concerns (though they certainly exist, cf EPC meeting) about a resurgence of inflationary pressures - should instead reaffirm common objective of achieving low inflation.

Para 3. Likewise no speculative references to 'renewed turmoil in the months ahead' on the stock markets, nor to market confidence remaining 'fragile'.

Para 9. (see also paras 27-9 on Asian NICs). US will probably want reference to NIEs ('economies') rather than NICs (countries), to include Taiwan and Hongkong - as per G7 communiqués.

Para 11. The suggestion that surplus countries should transfer 'excess' savings to LDCs seem to point the finger at Germany, given the acknowledgement of Japanese efforts.

Paras 12 & 14. Do these passages sufficiently reflect the Chancellor's concern to highlight the objective of exchange rate stability within a non-inflationary policy stance?

Paras 15-16. Usual FRG problems?

Para 17. What 'other policies' does Mrs Ostry have in mind?

Para 20. Add tax reforms, where appropriate? And would we mind a further reference to reform of agriculture in the European context of this paragraph? (It is mentioned as a Japanese objective in para 21). No explicit reference to FRG's possible contribution,
/but

but may be hard to secure although the draft OECD communique contains possible language.

Para 21. Add tax reform for Japan (which had no objection in the OECD communique discussions).

Para 22. Second sentence needs checking with DTI and Department of Energy (could mean PSEs for industrial and energy subsidies). We could strengthen last sentence, eg 'pledge their full support for' (unless Treasury thinks this is going too fast).

Para 23. Last sentence may be acceptable if it does not imply setting up new machinery.

Paras 25-6. We shall want to try to go further in the Summit communique. But hard to judge prospects until after OECD Ministeria. See also paras 31-5.

Para 28 makes a helpful distinction, which we should support, between Taiwan/Korea and Singapore/Hongkong.

Para 29. We need to be cautious about 'multilateral discussions' if this means treating the Asian NICs plus other emerging NICs as a group. Obvious problems over Taiwan and Hongkong participation.

Para 31. Check with DTI about enhanced role for Ministers in GATT. Improving GATT/IFI linkages certainly desirable, but Whitehall correspondence has also thrown up pitfalls, especially LDC suspicion of cross-conditionality. Need to proceed carefully.

Paras 33-5. See comment on paras 24-6 above.

Para 34. We should certainly like a reference in the Summit communique to 'agreement on the measures to be included' (i.e. commodity coverage), but can expect French/FRG resistance. We do not believe that the Summit will be able to agree on language or 'the target depth of cut' (i.e. what percentage of reduction of PSEs) nor do we think the MTM itself will get that far. This will have to be a matter for the subsequent negotiations in GATT. The last sentence is a sop to the Japanese. But has anyone thought through the implications? It sounds like an IEA-type agreement for food.

Para 35. The US will want to go into greater detail on each aspect of the trade negotiations. France/FRG/Italy may balk at 'approve a package of interim measures across a broad front'. Best prospects appear to be FOGs including dispute settlement, and tropical products.

Para 38. Interest rates: distinguish between real and nominal.

Types of support and maybe

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Para 40. Given the usual Congressional difficulties, we (and probably the US Administration) would like to communicate language committing all Summit countries to speedy approval of, and subscription to, the GCI. Need big plug for ESAF; and reference to EFF in communicate should emphasize case by case treatment and need for strong domestic reform effort in recipient countries.

Para 41. IFIS' 'catalytic' role OK, but resist language on Fund/Bank guarantees of new commercial bank money packages (only appropriate in exceptional circumstances).

Para 44. First proposal is Chancellor's. Second is new Canadian/UK proposal put to Paris Club. We want endorsement of a scheme at Toronto. Last sentence contains French proposals, which we regard as inadequate response (lowering of spreads etc must not be run as an alternative to the proposals earlier in this paragraph). No reference to aid targetry (0.7% of GNP) as such, but the reference to 'an increase in concessional resource flows' will need watching; in the present context it is fine because it leads into the Chancellor's proposal.

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cc HMT.

10 DOWNING STREET

From the Principal Private Secretary

9 May 1988

Just in case it hasn't reached you on other channels I am attaching two letters received today from Sylvia Ostry, one of which covers the thematic paper for our third Sherpa meeting.

I am sending a copy of this letter to Sir Geoffrey Littler (HM Treasury).

N. L. WICKS

R. Q. Braithwaite, Esq., C.M.G.



CANADA

Mr Wicks

I am enclosing a letter outlining the program for the remaining Sherpa meetings and the thematic paper.

*Sorry we missed
the weekend meeting
pardon to you Prime Minister.*

L J TAYLOR
Minister

With the Compliments
of the Commercial/Economic Division

de la part
de la division commerciale/économique

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6 May 1988

TORONTO ECONOMIC SUMMIT
THEMATIC PAPER

Developments since Venice

1. The Summit countries are now in their sixth consecutive year of economic expansion. Output growth in the past year has, on average, been stronger than expected. Unemployment rates fell markedly in North America and the United Kingdom -- where the pace of expansion exceeded potential growth -- but were either unchanged or increased in other Summit countries. Unemployment remains high in a number of countries, especially in Europe.
2. Inflation has been restrained. Nevertheless, recent developments in some countries have engendered concerns about a resurgence of inflationary pressures. Interest rates generally have declined, particularly since October, equity markets have recovered, and tensions in foreign exchange markets have eased.
3. Progress has been made toward the correction of external imbalances. The real trade balances of the three major economies have adjusted considerably toward more sustainable positions, although in US dollar terms current account deficits and surpluses remain large. The realignment of exchange rates in the past three years has contributed to the international adjustment process. So have the measures to stimulate domestic demand in surplus countries and reduce it in deficit countries. Fiscal consolidation has proceeded in countries with high fiscal deficits.
4. Over the past years, economic policy coordination among the Summit countries has been intensified and strengthened. Countries have agreed on the basic orientation of their policies and have made specific commitments to reach those aims, as demonstrated especially by the Louvre Accord and last December's Group of Seven statement. Substantial progress has been made in attaining the agreed policy objectives.
5. Nevertheless, financial markets have remained concerned about the persistent large international imbalances. These concerns were underscored by the late-October stock market turmoil and the subsequent foreign exchange market turbulence. Although a substantial degree of calm has been restored to financial markets, and although the October stock market plunge does not seem to have

significantly undermined consumer and business confidence, the risk of renewed turmoil in the months ahead cannot be excluded should the adjustment process appear to falter. Expectations and market confidence remain fragile.

6. To lessen the vulnerability of the world economy to turbulence in financial markets and defuse tension in the international trade and payments systems, governments must reinforce their commitment to the goals of sustainable economic performance and external positions. Government policies must be seen as credible in addressing those goals. Commitment and credibility will restore market confidence.
7. In the developing countries growth weakened in 1987, but the terms of trade recovered and, on aggregate, debt-export ratios declined for the first time since debt problems became acute in 1982. On a regional basis, however, divergence in performance intensified. The Asian economies continued to grow strongly, whereas the Latin American economies weakened considerably. Growth in Africa remained feeble.

Policy Coordination : Macroeconomic Policies and Exchange Rates

8. The foremost policy challenge facing Summit-country governments is to manage the transition over the medium term to more sustainable economic and financial positions in the context of non-inflationary growth. To meet the challenge, governments should firmly follow the agreed strategy of coordinated efforts to reduce spending in countries with large external deficits and stimulate domestic demand in countries with large external surpluses.
9. The reduction of external imbalances will require the cooperation of the Summit countries, of newly industrialized countries with rapidly growing external surpluses, and of some of the smaller European economies.
10. External imbalances have their counterpart in national saving-investment imbalances. For the past several years, private saving in the United States has been insufficient to finance the sum of domestic private investment and government deficits. Continued efforts to increase US private and national saving would contribute to the adjustment of international imbalances. Recent indications that the declining trend in private saving may have bottomed out are encouraging. In contrast to the situation in the United States, national savings in Japan and Germany have exceeded domestic investment.

11. Over time, as the U.S. federal government deficit is reduced, an increased level of national saving will be available to finance U.S. private domestic investment. It will be essential, therefore, to ensure that the savings the United States has been absorbing from the surplus countries find alternative productive outlets in order that world economic growth be sustained. For instance, the "excess" savings in the surplus countries could finance increased public investment (e.g., in infrastructure and human capital) or reductions in taxes that encourage increased private spending in the surplus countries themselves. Alternatively, the savings could be transferred to other countries, in particular to developing countries. However, given the reluctance of the private sector to invest in many developing countries, a transfer of savings to those countries would require an increase in official capital flows or incentives to private investors. In this respect, Japan's efforts to recycle part of its current account surplus to developing countries are encouraging.
12. At the Tokyo and Venice Summits and with effective use of the G-7 forum, the Summit countries have developed and strengthened the process of greater policy coordination. The process involves both the use of indicators in multilateral surveillance and an intensified system of consultation. The Summit itself serves as a forum for reviewing the progress made. In this respect, the efforts being made to refine the analytical use of indicators and possibly augment the existing set by the inclusion of a commodity-prices indicator are welcome. Summit countries should reaffirm their commitment to improved and effective policy cooperation.
13. The adjustment of international imbalances underway involves a shift of resources across sectors. In bringing about this shift, three factors play a role: exchange rates, expenditures, and structural flexibility.
14. The large exchange rate changes in the past three years, in particular the real depreciation of the U.S. dollar against the Japanese yen and the major European currencies, have played a major role in the adjustment of real trade balances experienced so far. The shifts in international competitiveness achieved should continue for a time to move external positions toward more sustainable levels. Under present circumstances, further large exchange rate changes would not serve the adjustment process.

15. Exchange rate changes alone, however, are not sufficient to bring about the desired adjustment of external imbalances. Changes in expenditures are also necessary; especially reductions in the rate of growth of private and public consumption in the deficit countries and increased domestic investment in the surplus countries. Without accompanying changes in relative levels of domestic demand across countries there would likely be continuing pressures on exchange rates. In the event, exchange rate changes could be counterproductive: capacity and demand constraints could translate the exchange rate changes into higher inflation in the depreciating countries and deflation in the appreciating countries.
16. The Summit countries have undertaken a series of fiscal and structural measures to bring about the required adjustments. Efforts in those directions must continue if the progress to date is to be sustained. The focus of markets is on continuing coordinated efforts to correct the imbalances; the expectation that appropriate fiscal actions will be taken within a medium-term framework is essential to underpin the market confidence necessary to maintain exchange rate stability.
17. Monetary policy in the summit countries has actively supported international policy coordination. But on occasion it may have been overburdened by being asked to simultaneously achieve a number of objectives: sustain growth, control inflationary pressures, and stabilize exchange rates. A potential conflict between exchange rate stabilization and domestic monetary objectives persists. It is imperative that other policies play a greater role if non-inflationary growth is to be sustained in a context of stable exchange rates.

Structural Policies

18. Structural policies are especially important at this juncture. By removing impediments to the effective working of market forces they would facilitate the sectoral adjustments associated with technological and demographic change as well as with the continuing correction of international imbalances. In so doing, they would help stem the tendency for protectionist pressures to shift as current accounts turn around. Moreover, a more efficient use of existing production possibilities would permit faster growth. This is all the more important in countries where available spare capacity is a constraint on non-inflationary growth, and especially

where the lack of productive capacity may be associated with high levels of unemployment, as in a number of European countries.

19. Summit countries have identified a number of priority areas in which structural reforms will be pursued. These consist of further tax reforms to enhance the efficiency of the tax system and to provide incentives to work, to save, and to invest; the elimination of wasteful subsidies; the deregulation of markets and the enhancement of competition and price flexibility; the reform of agricultural policies; and the removal of trade barriers.
20. In present circumstances, structural policies to complement macroeconomic policies are particularly called for in Europe, in order to spur job creation and to realize Europe's growth potential, and in Japan, so as to support the greater reliance on domestic demand-led growth. For instance, in Europe desirable structural reforms would include further liberalization of the transport and telecommunications sectors, elimination of wasteful industrial subsidies, and removal of impediments to labour mobility. Especially important for catalyzing significant structural reform and growth is the programme to complete the European Community internal market in 1992.
21. Japan could undertake to reform agricultural support and competition policies, reform policies pertaining to the use and taxation of land, and further liberalize its distribution system and transport sector. As for the other Summit countries, the most promising areas of structural reform in Canada would be implementation of the Free Trade Agreement with the United States, further tax reform, and the proposed liberalization of the financial services sector. For the United States, a priority would be to undertake reforms that would increase incentives to save.
22. Summit countries should pay special attention to those areas where international cooperation may spur structural reform and contributes to the full realization of its benefits. In the area of subsidies to industry, Summit countries should encourage the work at the OECD to identify and estimate government subsidies on an internationally comparable basis and assess their impacts, so as to encourage cooperative measures for the reduction or elimination of wasteful subsidies. More generally, Summit countries should welcome the further development of the OECD's surveillance of structural reform.

23. Financial markets free of distorting controls are essential for channelling funds to their most productive uses. Financial and technological innovations are rapidly integrating financial markets internationally. This entails both benefits -- a better allocation of capital -- and new risks -- in particular, the risk that developments in one country are more quickly, and fully, transmitted to other countries. The global integration of financial markets also complicates the supervisory task of regulatory authorities. Summit countries should cooperate in the examination of issues pertaining to the supervision of securities markets.
24. The governments of all Summit countries have undertaken, or will be pursuing, tax reform to render the tax system more equitable, remove distortions, and reduce disparities across countries in the taxation of various forms of income. With the increasing international integration of markets, differences in national tax systems assume a greater role in individuals' and businesses' investment decisions. Governments should continue to examine ways of removing discrepancies in national tax systems which distort incentives.
25. Governments recognize the very high costs which agricultural support policies are exacting in terms of budgetary outlays, high prices to consumers, and foregone output because of misallocation of resources; and their deleterious effect on a number of developing countries, including some highly-indebted ones. Reform of agricultural policies is a high priority of Summit countries in the Uruguay Round of trade negotiations.
26. To realize fully the benefits of national microeconomic policies to liberalize markets and enhance competition, it is crucial that an open international trading system be maintained. International competitive pressures improve the political climate for domestic structural adjustment. Thus, a successful Uruguay Round is of critical importance.

Asian NICs

27. The international integration of goods and financial markets and the rapid diffusion of new technologies have been changing the pattern of international specialization of production. Certain newly-industrializing economies, in particular the Asian NICs -- Korea, Taiwan, Singapore and Hong Kong -- have become increasingly important in world trade in manufactures.

28. Although the Asian NICs differ in many important respects, they are all characterized by dynamic, export-led growth which has allowed them to triple their share of world trade (both exports and imports) since 1960. In recent years these economies have evolved as major net exporters to the United States and net importers from Japan. But whereas in the case of Singapore and Hong Kong overall export growth has been broadly commensurate with import growth, Taiwan and Korea are now running sizeable current account surpluses. These surpluses are projected to decline only gradually in the next few years. Another Asian group, Malaysia, Thailand and Indonesia, termed the Newly Exporting Countries (NECs), are beginning to emerge as rapidly-growing exporters of manufacturers. There is a discernible trend to increasing integration by means of investment and trade flows within the dynamic East Asian region.
29. With increased economic importance come greater international responsibilities and a strong mutual interest in enhanced cooperation. In view of their growing importance in the world economy, there is a need for improved constructive dialogue between the industrialized countries and the Asian NICs, as well as the other outward-oriented countries in the region, on the international cooperative efforts required to achieve sustainable international adjustment. The development of informal processes which would facilitate multilateral discussions of issues of mutual concern, such as exchange rate and macro-policies, trade and structural adjustment policies, should be encouraged.

Multilateral Trading System

30. The multilateral trading system is fragile. Countries must continue to resist protectionism and the temptation to strike bilateral agreements outside the framework of GATT rules, and by making greater efforts to liberalize long standing trade restrictions. A successful Uruguay Round will invigorate the multilateral system and ensure its integrity, so that free and fair trade can once again become the engine of world growth. The Mid-Term Review in Montreal in December 1988 will provide a unique opportunity to send a positive political signal to the trading world.
31. To ensure this opportunity is not missed, Summit countries could draw attention to their ongoing concerns about improving the functioning of the GATT. This would be an important step to ensuring that protectionist pressures

are resisted and the liberalization of trade in goods and services achieved by the Uruguay Round is secured and enhanced. Attention could be drawn to the need to make the GATT a dynamic organization able to assume a lead role on a range of trade policy issues, in addition to a strengthened and reinforced contractual agreement. That would involve both giving Ministers a greater role in providing guidance to GATT, as well as improving linkages among GATT, the IMF and the World Bank. As a first step in that direction, Summit Countries could make a commitment to greater transparency by allowing GATT surveillance of all trade policies. It would also be necessary to emphasize the importance of strengthening the GATT dispute settlement system.

32. A major political and institutional consideration is the future role of developing and newly industrialized countries in the GATT system. These countries (especially the NICs), should be encouraged to undertake increased commitments and obligations and a greater role in the GATT, commensurate with their importance in international trade, the international adjustment process and their respective stages of development. Equally, developed countries should consider what they are prepared to do to meet the legitimate need of developing countries for greater, more secure access for their exports.
33. Reflecting the clear terms of reference provided by the Punta Declaration and the political impetus provided by the 1987 OECD Ministerial and the Venice Economic Summit, good progress was made during 1987 in the Uruguay Round negotiations on agriculture with the tabling of major proposals. However, this promising start now faces the difficult task of moving the negotiations themselves forward. The Summit should provide fresh political impetus and support to reinforce the efforts at domestic reform by advancing the process of agricultural trade reform and liberalization in the multi-country, multi-commodity context of the GATT round.
34. The clear policy challenge for the negotiators is to develop by the time of the Mid-Term Review the core elements of a framework which would include long-term and short-term components and improved GATT rules and disciplines for agricultural trade. The prime objective of the framework would be to make the agricultural sector more responsive to market signals. This would be facilitated by agreement on the measures to be included and the target depth of cut in the aggregate level of support and protection. Any short-term measures to

prevent agricultural trade distortions from becoming worse would need to be consistent with long-term goals. Concerns about food security could be met by exploring ways of sharing in times of severe or unanticipated scarcity.

35. At Punta del Este Ministers committed themselves to further trade liberalization across the wide range of goods and services including such new areas as TRIPS and TRIMS. The Mid-Term Review will take stock of progress in all negotiating groups, lay out the course for negotiations to conclude the Uruguay Round by 1990 and approve a package of interim measures across a broad front. This will provide confidence building signals about the Uruguay Round and the longer-term stability of the trading system.

Developing Countries and Debt

Middle-Income Countries

36. The strategy that has been followed since 1982 in dealing with the debt problems of the highly indebted middle-income countries has met with some measure of success:
- the risk to the international financial system from the large exposure of commercial banks to countries experiencing debt-servicing difficulties has been greatly lessened as banks strengthened their financial positions;
 - many indebted countries have begun a process of macroeconomic adjustment and structural reform which is necessary for a long-run resolution of the problem;
 - lending from official sources has continued to grow at a significant rate;
 - the 'menu approach' has continued to expand.
37. Progress toward a lasting solution, however, has been slower than earlier expected. Debt ratios remain high and the return to creditworthiness for many remains in the distant future.
38. The current market-oriented, growth-led strategy which takes into account the diverse situations of different groups of countries remains the only viable strategy. The central element of this strategy is the adoption of comprehensive macroeconomic and structural reforms by the

debtor countries. Without appropriate policies in the debtor countries themselves there can be no sustained progress. Another element is a favourable external environment: sustained growth in the industrial countries, expanding trade, and the avoidance of a resumption of high interest rates. A third fundamental element of the debt strategy is the availability of adequate levels of external financing.

39. There is some scope for optimism regarding all three elements of the strategy:

- many of the debtor countries are increasingly committed to the adoption of better domestic policies;
- economic activity in the industrial countries is expected to continue expanding at a moderate, but steady, pace;
- the terms of trade of the developing countries have strengthened, and although they are not expected to rise in real terms over the medium term, they should no longer be a source of weakness;
- the role of official financing is likely to grow, but the financing situation generally is expected to remain very difficult.

40. Almost all net new lending to the debtor countries is from official sources; since 1984 net private lending has shrunk considerably. Official financing has been extended on a large scale through the Paris Club: since 1983 over \$20 billion of debt-service payments by countries of the Western Hemisphere and Asia have been consolidated, of which a sizeable proportion represent rescheduled interest payments. Official financing and the international financial institutions should continue to play a central role in the debt strategy. Speedy approval and subscription by all governments to the \$74.8 billion general capital increase for the World Bank will substantially increase available resources. The IMF is providing additional financing to the poorest indebted countries through the enhanced structural adjustment facility (ESAF), and the modified extended Fund facility (EFF) will provide financing on more favourable terms and will place greater emphasis on medium-term structural adjustment. Also, the incorporation into Fund programs of external contingency mechanisms would assist countries in keeping to their adjustment programs in the face of unexpected adverse external events.

41. In view of the fact that about two-thirds of the outstanding debt of the heavily indebted middle-income countries is held by private creditors, their continued involvement in the debt strategy is essential. While increases in loan-loss provisions have resulted in a strengthening of the Banks' financial positions, they have also made the organization of new money packages more difficult. In this regard, the international financial institutions, especially the World Bank, can play an important catalytic role in mobilizing additional financing from private and official sources in support of countries' adjustment programs.
42. In addition to traditional rescheduling exercises, in recent years there has been increasing recourse to debt transformation and debt reduction techniques. The important characteristics of these financing techniques are that they are voluntary, market oriented, and applied on a case-by-case basis. To date, the "menu approach" has worked mainly to transform the nature of debt claims. However, the emergence of innovative approaches, such as the Mexican bond-swap scheme, could help reduce the existing stock of debt. The flexibility of the present strategy would be enhanced by the further broadening of the menu approach and the encouragement of innovative financing techniques.

Debt of the Poorest

43. Progress in dealing with the debt burden of the poorest developing countries has been encouraging:
- the recent enhancement of the IMF's Structural Adjustment Facility by SDR 6 billion will substantially increase disbursements on highly concessional terms to low-income countries;
 - the World Bank, in conjunction with ODA agencies, has put in place an enhanced program of co-financing aimed at the poorest countries;
 - Paris Club creditors are rescheduling debt at extended grace and repayment periods.
44. In cases where it is extremely difficult for countries to meet their debt-service obligations, an increase in concessional resource flows will be necessary to help those countries resume sustained growth. One proposal is to reschedule the commercial debts of the poorest countries at concessional interest rates. An alternative,

if less far-reaching, proposal is to allow creditors to choose between shorter repayment periods at concessional rates and longer repayment periods at commercial rates. The adoption of either proposal would be a positive development, especially if the interest relief is additional to countries' existing aid programs. Other techniques for reducing the burden of debt service should also be explored, notably in the areas of ODA debt cancellation and the lowering of interest rate spreads and fees charged by export credit agencies on rescheduled debt.

45. The debt burden of low-income countries is part of a broader developmental challenge. The developing countries themselves need to persist with efforts to implement effective programs of structural reform and macroeconomic adjustment. Developed countries need to support these programs over time with opportune and adequate concessional resources.