favour debt reduction for the borrowing countries. Second, there are important public benefits to be obtained by encouraging debt reduction for debtor countries. Debt reduction will assist debtor countries in their economic recovery efforts. It will also help to recover markets in those countries for Canadian exporters, since those markets have been seriously weakened over the past decade by the burden of heavy debt servicing. Furthermore, ongoing multilateral initiatives to reduce debt and encourage policy reform (notably under the Brady Initiative), will be supported by Canadian tax policy.

5. Canada could imitate the U.K. measures by giving banks a choice between "phasing" tax relief over time or obtaining relief "up front" by incurring losses through direct sales back to borrowers. The outcome would depend partly on sovereign debt provisioning regulations of the Supervisor of Financial Institutions and tax regulations based thereon. In particular, if the Department of Finance were to permit the maximum level of provisions allowable for tax purposes to increase from the current level of 45 percent of gross exposure, there could be an immediate tax loss of over $1 billion if all the additional provisions set aside in 1989 fell under the new ceiling. "Phasing" might spread this tax expenditure over three to five years, unless banks were to realize their losses through direct sales to borrowers, in which case the tax expenditures would be higher.

6. Alternatively, and preferably, debt reduction would be enhanced, and tax losses to the treasury restricted, under the following PROPOSAL:

(a) The current 45 percent ceiling on provisions (allowable for tax purposes) should be retained by the Department of Finance, while Revenue Canada should permit banks to claim as losses the difference between discounts on "eligible" loan sales (see (b) below) and the 45 percent already claimed.

(b) Loan sales "eligible" for the calculation of losses for tax purposes should include (i) sales to the borrowing country or bilateral conversions (e.g. under the Brady Plan); (ii) sales to third parties involved in bilateral debt conversion agreements (debt–equity swaps, debt–for–nature swaps and debt–for–development swaps); (iii) sales to other third parties working to effect debt reduction, such as the UNICEF–IDB Debt Reduction Facility currently under discussion among interested donor countries; (iv) finally, debt donations to organizations such as UNICEF (in its Debt for Child Development program in Africa) or NGOs working in co–operation with the borrowing country. Categories (ii)–(iv) should be added since these third–party transactions all result in some debt reduction, although implementation might prove to be complex.