# CRISIS
# OF
# THE '8Os

**Edited by**
**KHADIJA HAQ**

## FOREWORD

This volume brings together the ideas and papers presented at the Istanbul Roundtable, a meeting of thirty-six leading monetary, financial and development experts convened by the North South Roundtable and the UNDP Development Study Programmed for a brainstorming session in Istanbul. Turkey, on August 29September1, 1983. The Istanbul Roundtable addressed specifically:

• the inherent dangers in the current international monetary and financial situation and possible response to these problems;

• the enormous human costs for the poorest people and nations implicit in the present situation and specific proposals to avoid such costs;

• insufficient attention and support given to human resource development, which have strained economic and social progress; and

the opportunities for continuing and accelerating the process of global cooperation started after the Second World War.

Meeting in their personal capacities, participants in the Roundtable held candid debate and produced an array of fresh ideas on the issues. Some disagreement arose in the course of discussion, but on many questions a broad consensus of opinion emerged. The emphasis in the discussion was on correct diagnosis of the present world conditions, analyzing the true underlying strengths and failings of the international financial and monetary system, in order to prepare the ground for effective long-term solutions, not a short-term band-aid. Participants challenged many long-held beliefs and encouraged a process of rethinking, for the attainment of the kind of clear perspective which alone will permit real answers to emerge.

The Istanbul Roundtable was merely the beginning of a process of creative dialogue on the international monetary, financial, and human resource development issues—a process that we will continue in a series of meetings. We hope that these discussions will make a valuable contribution to the ongoing search for those policies and institutional changes which can best promote maximum and equitable growth of the world economy, which would accelerate human resource development, and which will lead to the full development and utilization of human potential all over the globe.

We offer our grateful thanks to the people and government of the host country, Turkey, for the very gracious hospitality that they provided to the participants. And we thank all the participants for their contributions toward the success of the Istanbul Roundtable.”[he issues of money, finance and human resource development will no doubt occupy central positions in the North-South devel-opment dialogue in this decade. Our effort, presented here, is only one more input into the debate—one more hopeful step toward a more stable and just world order.

Mahbub ul Haq Bradford
Morse

December 1983

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## ABBREVIATIONS AND ACRONYMS

ACT -African, Caribbean and Pacific
ADB -Asian Development Bank
ADF -Asian Development Fund
MDF -African Development Fund
BIS - Bank for International Settlements
CMEA -Council of Mutual Economic Assistance
CTLD --convertible Turkish lira deposit
DAC - Development Assistance Committee of the OECD
DMEC - developed market-economy country
EC -European Community
ECDC -economic cooperation among developing countries
ECLA - Economic Commission for Latin America
EEC -European Economic Community
EFF - Extended Fund Facility
GAB -General Arrangements to Borrow
GATT -General Agreement on Tariffs and Trade
GDI -gross domestic investment
GDP -gross domestic product
GNP -gross national product

GSP -Generalized System of Preferences
IADB -Inter-American Development Bank
IBRD -International Bank for Reconstruction and Development
ICSID - International Center for the Settlement of Investment Disputes
IDA - International Development Association
IFAD International Fund for Agricultural Development
IFC --International Finance Corporation
IFI - international financial institution
IIF - Institute for International Finance
IMF -International Monetary Fund
ITO -International Trade Organisat i on

LDC -less developed country
LIBOR - London Interbrain Offered Rate
LLDC - least develop country mint bank
MDB - multilateral Develop bank
NGO - nongovernmental organization
NGTA - no guaranteed trade arrear
N1C - newly industrialized country
NIEO - new international economic order
ODA -official development assistance
OECD -organization for economic cooperation and development
OPEC - organization for petroleum Exporting countries
R& D - research and development
SDR - special drawing right
SEE - state economic Enterprise
Sid - society for international development
TNC - Transnational Corporation
TPRC - third party reimbursement clime
UAE - United Arab Emirates
UN - United nation
UNCTAD -UN conference on trade and development
UNDP -UN development program
UNICEF -UN children's fund's
UNIDO -UN industrial development program
USAID -united state agency for international development
WPI -wholesale price index

## PREFACE

The financial and monetary crisis of the 'SOs is above all a crisis for the poor-for the poor countries and for the poor people in all countries. Fluctuating exchange and interest rates have affected the debt-ridden developing countries most; recession has hit the commodity exports of the LDCS hardest; and adjustment measures hurt the poorest in these societies most. In short, the true victim of the current crisis is the development effort of the LDCS. What is the nature of the crisis? Why has it come about? How is it affecting world development in general and growth in the LDCS in particular? And how are policy makers, national and international, responding to the crisis? This volume is a

compendium of answers by some of the world's foremost financial and development experts to these and other questions raised by the current crisis. The chapters include backd ground papers and presentations prepared for the Istanbul Roundtable, the first meeting of the Roundtable on Money and Finance, which is a forum established by the North South Roundtable for analysis and debate on monetary and financial issues as they relate to the development prospects of the LDCS. Some of the chapters of this book are based on transcripts of oral presentations. Others have been substantially edited, and the authors have not had time to review the edited versions. In this, as well as in the selection and organization of papers, I have taken an editor's liberty and take all responsibility for any wrong attribution: The volume has been divided into six parts. Part 1 is based on presentations at the plenary session, except chapter I, which presents the core group report to the Istanbul Roundtable. Parts 11 through VI present papers delivered at the various Roundtable workshops, and the Overview chapter in each part gives highlights of the workshop discussion and reporter's report. A short report on the Istanbul Roundtable, containing the Istanbul Statement, the core group report and the rapporteurs'reports on the workshops, was published and distributed to the governors of the annual World Bank; Fund meeting, to U.N. Ambassadors in New York and Geneva, and to the full membership of the North South Roundtable. The Istanbul Statement is appended to this volume. Also appended are two papers presented at an earlier meeting of the Roundtable on Money and Finance. wholesale pace index The North South Roundtable gratefully acknowledges the support provided by the UNDP Development Study Programmed for the Istanbul Roundtable and for this publication. Uner Kirdar, Director of the UNDP Development Study Programmed deserves special thanks for bringing together the concerns of money, finance, and human resource development, on which this Roundtable was based, and for his continued commitment to the cooperation of our two organizations. The Roundtable also acknowledges the financial contribution made by the World Bank.1 cannot conclude this brief preface without thanking the contributors who have made this volume possible, especially those who prepared written papers. 1 is indebted to Cesar Virata and Irving Friedman, Chairman and Vice Chairman of the Roundtable on Money and Finance, for providing leadership to this Roundtable. And finally, I must thank Agatha Andrews for her valuable assistance in editing and Jeanne Bright for her overall support in the preparation of this volume.

Khadija Haq
December 1983

# PART I

# THE ISSUES

" … it is vitally important that there be a clear and agreed diagnosis of what is wrong with the current international monetary and financial system and what cost it is imposing on the developing countries in particular and on their human and social institutions."

Mahbub ul Haq.

# CHAPTER 1

## Issues before the Istanbul Roundtable*

### 1. DIAGNOSIS

In the last thirty years there have been important changes in the world economy. The United States, which was responsible for more than 40 per cent of world GNP in the '50s, now accounts for about one-quarter of it, while the European Economic Community, Japan and a number of developing countries have substantially increased their participation in the total. Currencies like the Japanese yen and the German mark now play an important role in international trade and capital movements, even though their role is substantially less than proportionate to the relative significance of their economies in the world. These changes have economic and financial implications for the world economy. The increasing importance of currencies other than the dollar has generated a multi-currency system which enhances exchange rate instability. The expansion of Euro-markets has introduced an additional degree of volatility in capital and money markets. Since most countries are not willing to accept the exchange rate fluctuations that would result from a free market, they tend to dampen them, making use of interest rates, directly or indirectly, in the process. Thus, exchange rate fluctuations are transmitted to interest rates, and volatility becomes contagious.

The oil crisis added a new element to this general environment of change. Between 1974 and 1981, oil-exporting countries accumulated a surplus of roughly $500 billion, with annual rates fluctuating between zero and $100 billion over the period, becoming negative in 1982. The oil-surplus countries became important suppliers of funds to banks operating in international markets. The external assets of these banks grew at a rate of 20 per cent per year during this period, providing ample supply of financing to the world economy. For much of this period, interest rates in international markets were very low or negative in real terms so that deficit countries found cheap access to the financial resources they needed in the private international banking system. At the same time there was a sharp decline in domestic demand for commercial funds within the developed countries. In many developing coutries fighting inflation, domestic interest rates became higher than foreign rates, giving additional impetus to the demand for foreign loans. Some countries made use of the opportunity to increase government expenditure, while the concomitant deficit in the balance of payments was financed through borrowing. In other cases foreign loans financed increases in private sector expenditures.

The banks accommodated these demands and encouraged them with frequent visits to borrowing countries to promote their business. New and smaller banks joined

their larger colleagues, and made use of the opportunity to expand their total operations. Thus, the level of external debt of LDCs grew at the rate of over 20 per cent per annum. But the world economy was expanding fast. Trade and exports were increasing, so that debt-service ratios and debt-GNP ratios, while growing slightly, were no reason for concern. World liquidity was increasing through the expansion of the commercial banks' operations indication was the sharp increase in interest rates registered in the United States and Europe in 1980-81. The world economy had never fully adjusted to the changed circumstances of the 1970s: one consequence of the recovery that had taken place was upward pressure on inflation rates.

The authorities of the economically more important countries were I facing simultaneously large deficits in their government sector, inflationary pressures, and difficulties in their external sector so that a policy of restraint seemed clearly advisable. Major emphasis was placed on monetary policies to do the job. As a consequence, real interest rates shot upward, reaching unprecedented levels. The world economy slowed down rapidly, and prices of commodities and other exports of LDCs deteriorated to such an extent that in 1982 the terms of trade of the non-oil-exporting less developed countries reached levels as low as-and in some cases even lower than-those registered during the Great Depression of the '30s. The combination of unemployment and difficulties in the external sector led industrialized countries to take protectionist measures which produced further negative effects on LDCs. Sharp fluctuations in exchange rates introduced an additional destabilizing effect.

Many developing countries, particularly those in Latin America, found themselves in a situation where the stock of foreign debt had grown dramatically, most of it with private banks and subject to floating interest rates, so that an increase in interest rates affected most of the total stock of debt, rather than the flow of new borrowing alone. Fluctuations in interest rates became a new mechanism for the transmission of international disequilibria. This new mechanism aggravated the negative changes in terms of trade, complicating the situation further.

Furthermore, private bank financing slowed down dramatically. The drying-up of the capital surplus of OPEC in 1982 stopped the inflow of resources from this source into the banking system; and high interest rates and the recession itself weakened the quality of banks' portfolios, making them very reluctant to lend. Most smaller banks tried to withdraw completely from foreign operations. A few illustrative figures may give a clearer view of the situation. For 21 major LDC borrowers, the deficit on current account in 1982 was $61 billion, while total debt was $514 billion. Bank lending to non-oil LDCs in 1982 was only about one-third of the current account deficit. It is estimated that a I per cent increase in interest rates increases LDC current account deficits by roughly $2 billion, while a I per cent increase in the OECD growth rate would reduce the current account deficit by $15 billion.

The fact that the level of debt for some countries would be sustainable under "normal" conditions of the world economy is not intended to justify the policies followed by debtor countries during this period. Some countries followed expansionary policies that were not sustainable in the longer run; some followed insufficiently outward-oriented policies with over-valued exchange rates and pro, leetionism, which distorted resource allocation; and in some cases, the development of human resources was inadequate. Country responsibility for such policy deficiencies should be recognized. But the world recession has created a much greater need for adjustment than imprudent policies would have required. The preoccupation of the international community with the problem of Third World debt has resulted in some shift away from the emphasis that was being given to the problems of development in the low-income countries of sub-Saharan Africa and mainland Asia. One manifestation of this change in emphasis is the problem encountered by the soft windows of multilateral banks-in particular the World

Bank's IDA-in replenishing their resources. The multipolarization of economic power which has emerged over the past thirty years is in sharp contrast to the nearly monolithic system which obtained at the time of Bretton Woods. Then, the agreement and support of the U.S. was sufficient to secure international reform. Today, the support of a number of countries is needed, countries which have divergent views and interests. Hence, despite the need for reforms, the political problems and obstacles to reform are intrinsically greater than in 1946

## II. CURRENT RESPONSES TO THE SITUATION

The combination of the developments analyzed above has given rise to a series of major debt crises. Twenty-four countries have renegotiated their debt since 1980, with the renegotiations of Poland, Mexico and Brazil dominating in magnitude and potential implications. But the crisis of debt has not been confined to the middleincome countries; in 1981 and 1982 eleven sub-Saharan African countries had to have their debts rescheduled, some of them repeatedly. The international response to these crises-by each of the major actors, governments, international institutions and the commercial sector-has been ad hoe. On each occasion a package has been patched together to ease the immediate crisis. But no long-term solution to the underlying problems has been developed. In some respects the crisis measures have added to burdens in the medium term, by increasing the cost of the funds rescheduled by the commercial sector. In some cases they have resulted in a sharp decline in the levels of net transfers. The IMF programs have required major deflation and cuts in imports of around one-third in the cases of both Mexico and Brazil. Conditionality associated with restructuring of debt in the poor countries has also had deflationary consequences. Achieving these cuts would release foreign exchange for debt servicing, but at a heavy political and economic cost.

In this context, the aggregate effects of policies which are being recommended to deficit countries have not been duly considered. While devaluation by one country may improve its external balance, devaluation by a large group of countries would produce a negative effect in their terms of trade and very little improvement in trade balance. Restrictive economic policies in one country may help balance its external accounts, both reducing imports and expanding exports. Restrictive policies applied by many countries at the same time would leave little room for export expansion, So that the major burden of adjustment would fall upon a reduction in imports and economic activity all-round. The response to the crisis has has been largely directed at securing adjustment by the debtor/deficit countries. Inadequate attention has been paid to securing adjustment in surplus countries through increased growth and/or increased long-term lending. The burden of adjustment in developing countries has been made heavier by the lack of sufficiently expansionary policies in surplus countries. Moreover, lending by the private sector to non-oil developing countries is decreasing significantly, falling from $50 billion in 1981 to $21 billion in 1982. At the same time, growth in development assistance is falling off. Agreement was reached to increase the Fund's resources (although by an inadequate amount in relation to the size of the problem), but this might yet be thwarted by resistance in the U.S. The same problem of less-than-adequate response from the U.S. made it difficult to refinance IDA.

## III. CONSEQUENCES OF PRESENT RESPONSES

While a reduction in spending and efforts to bring imports and exports into better balance must be part of any collective effort, the continued slowdown in

private sector lending and the inadequate response of governments and international institutions mean that many LDCs have had to adopt sharply deflationary policies. At present, GNP in Latin America is falling for the second year in a row (as has not happened since the '30s), while unemployment levels can only be compared to those of the Great Depression. For the fifth year running, sub-Saharan African countries have experienced negative growth in their GNP per capita. Growth in developing countries as a whole was 2 per cent in 1981 and 1982, two-fifths of the rate of the 1970s and below the growth in population. With an adjustment effort of this magnitude the current account deficit of Latin America has been cut to less than half that of 1981 and thee trade account will be in surplus in 1983, so that Latin America as a whole will have a net outflow of real resources. Estimates for all non-oil LDCs show a significant reduction in the current account deficit, on the order of $35 billion. Since LDCs account for nearly 40 per cent of U.S. exports and 28 per cent of OECD exports, these measures have had a sizable impact on world demand. This has accentuated the trend towards protectionism in enveloped countries, induced by their high levels of unemployment. In general, throughout the world, the crisis has produced a retreat from multilateralism.

A few developing countries have been able to adjust through expansion of exports (for example, South Korea), but this does not appear to be a feasible option across the Third World, unless world demand recovers significantly and developed country protectionism diminishes. In the present situation and with the current responses of the international community, deflation is the main option for most LDCs, especially those countries whose past inward-looking policies have made it difficult to achieve a rapid increase in exports. But sustained deflation is, of course, costly in social and political terms, as well as economic. In some countries, political stability is at stake as a result of the continued application of these policies.

For some countries, then, default may become a tempting alternative. Countries which have to run a substantial trade surplus in order to meet their debt service obligations may see default as a way to increase their immediate import potential, since at present some are transferring resources to the rest of the world in net terms. Morgan Guaranty. estimates that net financial transfers to the 21 major LDC borrowers will be negative in the near future. Default would, of course, have serious consequences for the countries as well as for the international financial community. But in the present situation, this course of action may be seen as a possible response for some countries. This possibility underlines the urgency of developing constructive long-term solutions. The short- and long-term implications of default for countries and financiers need detailed exploration to avoid miscalculations. Here we note it as a further and urgent reason for requiring new responses from the international community.

## III. THE PREFERRED OUTCOME

Above we have briefly described the situation that has emerged and recent responses to it. The outcome is clearly not a desirable one, from the point of view of any of those involved. The political fabric of many countries is being strained; their people are facing reduced incomes, rising unemployment and cuts in social services. Investment in human resources, vital for the long-run development effort, is being eaten into. While the international banks' immediate viability has been sustained and their short-run profits increased, they remain highly vulnerable to further crises. The world has lurched from crisis to crisis, and the dynamic multilateral system established after the Second World War has been greatly weakened. The present situation does not make full or efficient use of the world's economic potential, nor does it contribute to the alleviation of pressing social needs.

The preferred outcome would involve a steady and sustained expansion of world demand, output and income. This outcome would require an appropriate expansion and distribution of world liquidity, to sustain such growth and help offset cyclical fluctuation. Expansion in trade and output could be expected to be accompanied by renewed multilateralism in trade and payments.

To achieve such an outcome, symmetry would be needed in the adjustment process, with adjustment by surplus countries as well as deficit, and with a special responsibility on surplus countries to expand when world demand is cyclically low and unemployment is high. Large economies not constrained by inflation or balance-ofpayments conditions should also pursue growth-oriented policies. Deficit countries need to undertake adjustment policies, and in some cases restrictions in demand would be appropriate. But in a growing world economy, many countries would adjust primarily through expansion of supply and exports, rather than by excessive restriction of demand.

This picture of the desired outcome may sound somewhat overly optimistic. However, it is helpful to have such a clear goal in mind when assessing required changes in the international financial system.

## IV. LOW-INCOME COUNTRIES

In this overall environment, the situation of nations with very low incomes deserves special attention. These countries have been hard hit by the weakness in commodity prices and have very limited capacity to adjust. Access to commercial markets is meagre, and prospects for sufficient increases in aid appear poor. First, the lowincome countries need increases in concessional assistance to make progress in attaining some of the vital goals in levels of health, education, nutrition and housing of their populations, and to establish the infrastructure needed for further economic development. While some donor governments clearly face pressure to reduce their budgets, the proportion of budgets devoted to official development assistance is very small-on the order of I per cent for all developed countries taken together. As already indicated, the response of the donor community to the present crisis in low-income countries has not been very generous. For instance, severe limits on IDA funds are being imposed, while major increases in IDA are entirely justifiable on the grounds of the effectiveness of its use and its benefits to development.

The retreat from multilateralism, which is manifest in reduced donor support to multilateral confessional flows, reverses a very favorable trend. From 1970 to 1982, the volume of multilateral concessional flows in total ODA increased significantly. Since some 90 per cent of multilateral ODA is provided to the poor countries, this meant that by 1982 there was more focus on low-income nations than ever before. At present about 50 per cent of all ODA-'multilateral and bilateral-goes to poor countries. However, the move away from multilateralism will lower this proportion, since bilateral ODA is concentrated on the middle-income countries.

As the low-income countries attempt to develop their human capital, support for their efforts is necessary, both from bilateral sources and through the UNDP. In many nations, improvement in human skills and education are needed to strengthen development prospects in many sectors of their economies and to distribute more broadly the benefits of growth. Yet during periods of crisis, this area of need tends to be neglected. Both developing nations and donor governments must avoid this tendency.

There is need to formulate a special program of action for sub-Saharan Africa that would direct in larger amounts of ODA Bows under conditions more appropriate to the situations of these countries. In addition, the bilateral aid agencies should formulate programs of quick disbursement, along the lines of a program already initiated by the World Bank.

Finally, while industrialized countries' protections against manufactured

exports are of major concern, their distortions in agricultural trade-especially through production and export subsidiespresent an even more serious problem to poorer countries, most of whose exports are in the form of commodities. Much development assistance to these nations is negated by the harm done to their exports by such distortions. An urgent effort must therefore be made to reduce and ultimately remove these protections, or at least to put a "standstill" on new ones. An extension of the size of the IMF's Compensatory Finance Facility for commodities would provide a significant source of assistance to poor countries where commodity prices are especially low.

## V. INSTITUTIONAL ISSUES

As a growing number of pressures weigh on the international economy, questions are often raised as to the ability of existing institutions to cope with the broad range of problems. It should be considered whether key objectives are being met by the existing institutional structures; whether and what types of improvements are necessary; and, if existing institutions cannot meet certain needs nor be improved so as to be enabled to meet them, whether new arrangements are necessary. It is clearly undesirable to introduce new institutions when improvements in existing ones would suffice, especially since such innovations consume much time and create uncertainty. But it is necessary to consider the creation of new institutions if existing ones cannot be improved adequately to achieve important objectives.

There are a number of areas in which important institutional questions have been raised:

1)**The adequacy and distribution of global liquidity**: In the discussions which led to the creation of SDRs there was considerable debate over the role of international institutions in creating and distributing international liquidity. The SDR was designed to permit the Fund to augment liquidity with an instrument which would also reduce dependence on the reserve role of the dollar. But this asset has been created only in limited amounts. There has been constant pressure to provide developing nations with a larger proportion of new SDR issues (either directly or through "the link"). In the short term, a decision will have to be made as to whether there is a present need to create additional SDRs (and we believe that there is) and if so, how many. In the longer run, it will be important to address institutional questions such as: Can the IMF play a more active role in creating additional liquidity when appropriate? Are changes needed to make the SDR a more broadly used international asset? Are new institutional arrangements needed or desirable?

2**) Exchange rotes**. Exchange rate volatility and misalignments which distort trade have had a major impact on 'he economies of a number of countries and on key sectors involved in international trade. There is a general desire for greater exchange rate stability, and a major debate is under way as to how to achieve it and avoid major misalignments. Exchange rate intervention has been advocated, to avoid or to moderate temporary aberrations in the market; but intervention cannot correct major movements in rates, especially when private participants in the market have far more funds with which to intervene than have governments. In the final analysis, convergence of underlying economic conditions presents the best likelihood of reducing exchange rate volatility; yet this goal has proved elusive, as sovereign governments resist coordination which reduces their policy flexibility. Are new arrangements or patterns of cooperation needed to deal with the underlying causes of misalignment? Can better means for coordinating exchange rate intervention be found? Are current institutional arrangements adequate to facilitate it?

3**) Lender of last resort**: Debt problems are more intractable, the later their detection. Is there any early warning system for debtors or for creditors? When difficulties arise, should support be provided? To whom: creditors or debtors or both? By whom: national authorities present international institutions, a new

institution? If in the present liquidity crisis, countries facing large 'ebt burdens cannot obtain sufficient assistance from the IMF, how can or should necessary funds be provided-bilaterally or through international entities (e.g., the Bank for International Settlements)? Or are hew institutional arrangements appropriate to supplement the efforts of the Fund and the HIS? The absence of an acknowledged lender of last resort in the world economy is one factor slowing down bank lending to LDCs. However, any such instrument would have to be carefully designed to avoid imprudent borrowing and lending.

4**) Debt rescheduling**: At present most public debt is rescheduled in the context of the Paris Club, and most private debt (held by commercial banks) is rescheduled through ad hoc arrangements, usually coordinated by lead banks. Growing attention is being given to finding ways of smoothing out the rescheduling process in order to reduce uncertainties and delays which trouble both lenders and borrowers. Should improved arrangements be made in such a way as to maintain the informality and consequent flexibility which characterize the present process, or are new arrangements needed (e.g., a more formal secretariat or internationally agreed procedures)?

5**) Balance-of-payments adjustments**: The international adjustment process has been criticized for its lack of symmetry. It is probable that deficit countries will be forced to adjust, to avoid a further weakening of their currencies or negative employment effect of large trade deficits, while surplus countries generally feel less pressure to adjust because of the employment and exchange rate benefits of large trade surpluses. The lack of symmetry is demonstrated in the pressures the debtor countries are currently facing while surplus countries bear no parallel pressure. This lack of symmetry raises the question, whether there are ways of providing new incentives for both deficit and surplus countries to adjust. Ideally, incentives should be devised to encourage such adjustment before imbalances present major problems.

**6) Growth strategy**: As countries formulate their domestic economic policies, there is a need better to understand both their impact on others and the impact of others' policies on their efforts. For example, one country's policy to reduce its growth slightly to avoid overheating can be turned into recession if, at the same time, other countries pursue highly restrictive policies with the effect of dramatically curtailing that nation's exports: Likewise, common efforts by many countries to reduce balance-of-trade deficits or to run surpluses can lead to an unexpectedly large slowdown in global growth, reducing prospects for recovery and complicating balance-of-payments adjustment for many countries. Among industrialized countries, the OECD tries to forge understandings-if not coordinated policies-to reduce over- or under-shooting. But it has rarely succeeded. Moreover, with many non-OECD countries now playing an active role in the world economy, it should be considered whether a broader effort to institutionalize exchange of information and to assess aggregate policy impact is desirable. Can this be done in the IMF, the Bank, or a UN agency, or are new arrangements required? The need is not only for exchange of information; it is a matter of countercyclical action. This could take the form of adjusting the nature of IMF conditionality according to the state of world demand and employment. For this to be possible, the Fund would probably need greater resources. Another possibility is to adjust the creation of international liquidity to offset cyclical fluctuations in world demand.

7**) Interest rates**: Because interest rates have such a large impact on domestic economies and on payments flows (due in large part to the increased use of floating-rate debt), there has been considerable attention devoted to ways of bringing rates down in real terms to normal levels. Yet methods of achieving this goal have eluded governments and economists. Therefore it is useful to discuss why real rates have remained so high, whether it is a cyclical or structural problem and whether governments, individually and collectively, can improve upon recent performance. The burden of fluctuating interest rates has

been accentuated recently by the coincidence of high interest rates with poor terms of trade. Various measures have been suggested for reducing the burden of these fluctuations. One proposal is to relate interest payments to commodity prices. Another is for the creation of an Interest Compensation Account at the IMF. Intermediary financial institutions might also perform a role in undertaking some of the risks of fluctuating rates.

8**) Involving new lenders**: During the last decade there was an increase in the proportion of overall lending to developing countries coming from commercial banks. Now, banks are becoming more cautious. It is therefore important to explore new ways of encouraging the banks to continue lending, to involve new potential lenders (e.g., insurance companies), perhaps by creating a secondary market for bank credits, and to encourage equity investors to play a greater role. Much of this will be a function of the profitability and security of investments and of the receptivity of countries to them. But the process can be facilitated by institutional arrangements which minimize risk and combine government or multilateral funds or guarantees with private financing. World Bank, ADB and IADB co financing has been an important step in this direction, but other institutional arrangements also should be explored. Several proposals have been advanced recently, involving both public and private sectors and new financial instruments.

9**) Trade and financial/monetary issues**: Until recently there has been little contact between trade and financial/monetary policies or policy makers. Thus the impact of exchange rate misalignments on trade and of trade distortions on debt problems have not been given adequate attention. The current debt situation has resulted in a sharper focus on this subject and discussion as to how to improve the policy dialogue among the IMP, GATT, IRRD, UNCTAD and governments. It is worth considering whether and how further improvements in this area can be realized.

## VI. PRIORITY ISSUES

Priority should be given to assisting low-income countries. This involves:

increasing the new flow of resources to these countries, which is largely a matter of increasing their access to official funds-a large replenishment of IDA and timely contributions are of the first priority;

strengthening commodity prices-which would naturally rise with a sustained expansion in aggregate world demand-and removal of subsidies and other distortions which adversely affect these prices

an additional general allocation of SDRs, which would contribute directly to countries' liquidity and indirectly to their prosperity by raising world demand; and

reduction of protection and subsidies in large trading countries and groups of countries, especially on those products of particular interest to the poorer countries.

These measures would also make a considerable contribution to assisting middle-income LDCs.

Another priority should be a sustained expansion of world demand, which would strengthen commodity markets and enable countries to adjust through export expansion, raising employment and reducing protectionist pressures. In order to achieve this objective, current deflationary policies in many countries will need to be reconsidered and reversed.

A concerted effort should be made to identify and introduce measures to secure new sources of funds and investment for developing
countries, e.g., from insurance companies and other institutional investors, and to retain existing lenders. Measures that require exploration include cofinancing between public and private sectors and the development of secondary markets in loans and financial instruments. There is a need to examine promising new

forms of equity investment and to improve opportunities for obtaining them. Establishment of a Third World Bank through the combined efforts of a few developing countries or through the mobilization of private channels seems a promising idea.

We have identified a number of functions that appear to be inadequately fulfilled at present. It has been suggested that many of these might be grouped together and performed by a World Central Bank. The functions could include:

- assisting the management of world liquidity to keep it appropriate
- priate to global needs for sustained growth with stability;
- acting as lender of last resort for the international economy;
- facilitating efforts to reorganize external debt when necessary;
- influencing international interest rates;
- improving exchange rate interventions; and
- Monitoring international banking practices.

There is a need for a study to examine whether and to what extent these functions are being performed adequately today; what alternative mechanisms might fulfill such functions, including existing institutions and the creation of one or a number of new institutions; and what transitional arrangements would gradually build momentum towards long-term solutions. Such a study should not determine definite solutions, but should prepare the way for the wellinformed debate on these issues that is urgently needed.

# CHAPTER 2

## Why the Current Financial Crisis?

**Mahbub ul Haq**

The problems that we are discussing in this Roundtable are problems as old as civilization itself-problems of poverty and income disparities-problems which have persisted through the ages. We have come to Istanbul, to this cradle of civilization, to seek some honest solutions to these persistent problems.

Our intention is not to offer any preconceived solutions. We have come here in a spirit of objective inquiry and honest dialogue. Our purpose is to generate a process of rethinking the international financial and monetary system. In the 1940s. It took years of intellectual inquiry and three years of intensive dialogue to conclude the Breton Woods agreement. At that time, there were only two major parties to the negotiations-the United States and the United Kingdom. For the institutions of the 1990s and beyond, it is going to take years of intellectual dialogue and several years of painstaking negotiations, since the world has become far more diverse and complicated since the 1940s. Therefore, our purpose here is to begin a process of inquiry, rather than to seek or settle on final solutions.

In the first place, it is vitally important that there be a clear and agreed diagnosis of what is wrong with the current international monetary and financial system and what cost it is imposing on the developing countries in particular and on their human and social institutions. In this inquiry, I would like to focus attention on five major issues.

First, in the last thirty years, economic and financial power has become multipolar. It is no longer monolithic-no longer concentrated around one major economic power, the United States. And yet most of the economic and financial policies and systems have remained essentially monolithic in their control. The U.S. was responsible for 40 per cent of world GNP in the 1950s; it accounts for only one-quarter today. Currencies other than the U.S. dollar are becoming increasingly important in international trade and capital movements. There has been a rapid expansion of Euro-currency markets. As a result of the increasing

multiplicity of the financial world, exchange rates and interest rates have become quite unstable.

During this period, when the world has been becoming more diversified, most of the financial and economic policies still revolve around the same monolithic system that emerged in the 1940s. This is evident in at least two very clear developments: (i) the creation and distribution of world liquidity, and (ii) the lack of symmetry of adjustment between debtor and creditor countries. At the moment, most world liquidity is created not by an international system, not through the SDR5 of the IME, not through the consensus reached between a number of nations, but largely as a reflection of the national policies of the United States, since the U.S. dollar is the chief international currency. Whether total liquidity is adequate or not, whether it is distributed properly or not, are matters of accident, not matters of planning or good management.

As to the second development, the lack of symmetry between the adjustment imposed on deficit countries and surplus countries, it is clear that deficit countries, not having any easy access to international credit, bear much harder adjustment than the surplus countries, which are under no immediate obligation to adjust. The burden of adjustment, as happens in the law of the jungle, falls disproportionately on the most unfortunate and the weakest members of the international community, not on those most capable of bearing this burden. The developing countries may scream as much as they like that the burden of adjustment is paralyzing their development, but the protests are in vain since this kind of discrimination is built into the very structure of international finance. And all this arises from the same fundamental problem, that while the world system has been becoming multipolar, the policies governing this system have remained monolithic.

The second major issue, also contributing to the new multipolarity, is the increasing role of private capital markets since the 1940s. This is a development totally unforeseen and unaccommodated within the original framework of the Bretton Woods system. In fact, these private capital markets increasingly have become more important than the official flows. One particular development which accelerated this trend was the rapid rise of oil prices in the 1970s. During the last decade, there has been an accumulation by OPEC countries of $500 billion of liquidity, which they had to deposit mostly in the commercial banks of the developed nations. The external assets of these commercial banks increased by about 20 per cent a year during the 1970s, providing an ample supply of liquidity to the world economy for a certain period. However, what was wrong with this system was that this creation of liquidity remained both unregulated and uncertain. It was unregulated because it was a reflection of OPEC surpluses, and as these surpluses diminished, many developing countries were faced with a liquidity crisis. (The crisis in Brazil or Mexico today is a liquidity crisis, not a development crisis.) That it was uncertain is shown in our recent experience: in 1982 the lending of commercial banks to 21 major developing countries was about one third of their current account deficit of $6I billion. In fact, according to Morgan Guaranty analysis, the net transfer of funds to these major developing countries would become negative in 1982. Thus, a situation of ample liquidity that many developing countries mistakenly took for granted in the late 1970s suddenly and abruptly changed. Our second dilemma, then, is how to accommodate the tremendous expansion of private capital markets and the role of commercial banks in the new international monetary and financial systems.

Third, all analysts are agreed that the only viable long-term solution for most of our present difficulties is the sustained growth of the world economy. Such growth will expand markets, it will help reduce current temptations for protectionism, it will assist those forces which are trying to expand aid levels, it will mutually reinforce growth of various societies, and it will ease adjustment problems even in developing countries because every I per cent additional growth in OECD might reduce the deficits of developing countries by about $15 billion. Yet, and this is our third dilemma, that kind of sustained international growth

itself is impossible in the context of the financial and trade policies which we currently are pursuing. World growth is hindered by the present system of creation and distribution of world liquidity. It is hindered by current trade protectionism. It is hindered by deflationary policies in most developed countries. It is hindered by the curious I M F prescription for most developing countries to deflate their economies-a prescription which might be all right taken individually, but which, when taken at once in country after country, can only end up deflating world output and employment levels. Thus the solution that we all seek, and the one we are willing to bet on that is, a sustained world economic recovery-is itself a hostage to the reform of the international monetary, financial and trading system.

Fourth, there has been a gradual retreat from multilateralism over the last decade. There has been an increasing temptation to turn inwards, to find national solutions even when the problems have overwhelming international dimensions. At a time when we all fondly hoped that there would be a further evolution of multilateral policiesof multilateralism in the World Bank, GATT and IMF, whether through gradual reforms or through a major restructuring-we were confronted with a weakening of the support of governments for these international institutions and an unmistakable trend towards bilateralism. And we helplessly witnessed the struggles-in summits of industrialized countries, in U.N. forums, at the Summit at Cancun—to find solutions for problems for which institutions had already been created in the 1940s. 1 regard all this feverish searching in various ad hoe forums as an indictment of the system itself, for the Bretton Woods system should have been empowered to change and evolve with the changing times. The fault in this case is not with the institutions but with the real authority and mandate they have been given by their members.

The fifth issue concerns the human and social costs of short-term adjustments. Education and health budgets are the first to be cut in many developing countries, as the struggle for short-term survival wins over long-term development. If we take the balance sheet of only the last one hour, while we have been deliberating in this Roundtable, then in those 60 minutes this world of ours has spent $60 million on armament, at the rate of $I million a minute. During the same 60 minutes, 2000 small children have died, after waiting in vain for the less than $1 million needed to rescue them from that fate. During the same 60 minutes, developing countries have paid $20 million in debt servicing. And many of their policy makers made this cruel choice with trembling hands, because they know well the same money could have been used for food production or for essential imports-could have lowered somewhat the human costs exacted on these societies. This quiet human drama goes on as we debate these issues. These human and social costs are tearing apart the political and social fabrics of many societies as we struggle to find technocratic solutions to international monetary and financial problems.

These are some of our problems and dilemmas. There are many more. The real question is, what are the responses of our institutions? The plain fact is that the institutional responses are weak and feeble. There are certain essential functions in the international monetary and financial system which is not being performed adequately today. Let me briefly list these functions.

First, we have to find a mechanism to ensure adequate creation and distribution of world liquidity. Second, we have to find some means whereby the resource needs of the poor countries can be met, since they will not benefit much either from the expansion of the private capital market nor even by some of the reforms of the world financial system. They might benefit indirectly from increased global liquidity, which would strengthen commodity prices; but the availability of development finance on concessional terms remains the central issue for them-an issue which tends to fall on the sidelines in this debate, although it is sometimes revived by the idea of additional liquidity being linked with development assistance (“SDR link”).

Third, there is a need today to mobilize new lenders (for instance, insurance

funds) which may not be finding suitable channels for investment in developing countries. There is the task of organizing a secondary market for commercial issues. And there is a proposal to establish a Third World Bank by a few developing countries or even through private channels; this is reportedly under active consideration. What are the innovative ways through which the new sources of lending can be mobilized, since the traditional sources may not expand very rapidly?

Fourth, the issue of restructuring the debt of developing countries, as well as restructuring the debt portfolios of commercial banks, is of prime importance. Most analysts by now agree that these debt portfolios, whether of commercial banks or of developing countries, are unsustainable. They have become too short-term in nature and need to be lengthened. There arc a number of proposals for lengthening them, but there is a cost involved in changing the portfolios, and those proposals are not being implemented. Who is to bear those costs? Should there be an institutional intervention to arrange debt restructuring for developing countries as well as for commercial banks? These are real issues for debate.

Fifth, 1 mentioned earlier the lack of symmetry in the balance-of payments adjustment. How are we going to bring about symmetry? The surplus countries have successfully resisted any major structural adjustments for the last three decades. And yet they know (as we all do) that today's winner may be tomorrow's loser, because they are only accumulating problems for the future. What we need to consider is an automatic system that will oblige surplus countries to share the burden of adjustment with deficit countries.

Sixth, we often discuss the question of world growth management.
There are several dimensions of this issue which generally remain separated in discussion although they are essentially interlinked: finance, monetary policies and trade. Often developing countries may gain much more by the opening up of world markets than by some of the arrangements for financial assistance. Who is going to ensure that the world growth impulses remain adequate overall, that world growth is managed in the best interest of all societies?

Seventh, there is the issue of exchange rate and interest rate instability. It has been suggested that one percentage point increase in interest rates imposes a burden of $3 billion a year on the developing countries. Should there therefore be a compensatory mechanism for interest rate changes in the IMF, or should there be some other institutional reform?

Eighth, there is the question of overview of private capital markets which so far have remained fact is that our institutional responses and our institutional development have lagged far behind our economic and social growth and our growing interdependence. And it is this issue of institutional development which must be foremost in our deliberations.

Let me conclude with some remarks about the proposal of a world central bank. This has been a hotly debated issue. The proposals put forward by Keynes in the 1940s have still not been fully fleshed out. We must look at the functions that a world central bank would be supposed to perform and then ask ourselves whether those functions are being performed well today, whether there are some reforms of existing institutions which would enable them to perform those functions better, and whether we may gradually come to a stage where the international community will find it convenient and acceptable to group some of these functions together under some sort of a world central bank. If we proceed on these lines, it will be the
beginning of an honest debate. My own conviction is that the time is fast appc8aching when the idea of a world central bank or a second Brettod'. Woods will no longer be fights of fancy. But I would like to build this case, brick by brick, by an analysis of the functions which are either'r being performed inadequately or not being performed at all od tae world financial scene. largely unregulated. The very mention of planning and management raises screams of protest throughout the

private capital markets. And yet, for their own health and for world benefit, we need a system both to protect them and to protect ourselves. What is the fine balance that we are going to seek to ensure the economic health of our world banking system and yet avoid a regime of unnecessary and unacceptable regulations?

Finally, who is to perform the role of the lender of last resort? Is the IMF going to be enabled to play this role, and even a countercyclical role, so that it can increase its operations whenever world liquidity decreases, and vice versa? Or should some new institution take on this role? The

Let tne:recall that last year when we met in Oiso and issued our Declaration asking for a conference on money and finance and for the bpgj4ping of a debate on Bretton Woods 11, there was a bit of derisige'(Mighter around the world and a suggestion that we were being tddihaive and idealistic in our approach. We have come a long way in the last year. The same call for an international conference on money :aid finance was taken up by the Non-Aligned Summit of over 100 gluons in New Delhi in March this year. The issue was also taken d1 in the Williamsburg Summit of seven industrialized nations. There has been at least a grudging admission that these are serious Sues and that they require a serious discussion.

This Is, there fore, a time for sober reflection, not in a spirit of belligerence, but in a spirit of compassionate analysis. We need not paralyze bur initiatives for fear of the unknown, for we are here as seekers of honest solutions to the great problems our world community faces. There are times when boldness is required, but boldness creai its own fears. There are times when fresh imagination is needed,. &Qt this imagination must be practical and rational. In this dim twilight of reason and ideology, in this curious atmosphere blending ietionality and emotion, let us choose our way very carefully but without fear. Let us start here a process of inquiry that can lead us, stop by step, surely and steadfastly, to the eventual solution.

## CHAPTER 3

### Confronting the World Crisis*

**H.E. Sermet R. Pasin**

On behalf of the Turkish Government, it is a great honor and privilege for me to welcome the distinguished participants to the Istanbul Roundtable. We are extremely pleased that this important meeting is convened in our country.

There is no doubt that the themes to be dealt with at this Roundtable are of fundamental interest andd concern to the whole community of nations. In particular, the financial and monetary problems now besetting the world economy have acquired unprecedented proportions, threatening the well-being of all countries, developed and developing alike.

We are all aware that for the past three years the world economy has undergone a period of recession. World production has decreased sharply, and international trade has been stagnating since 1980 and declining since 1981. The developing countries are the ones most heavily affected by the present world economic crisis. While their population growth continues unabated, production and trade are at their lowest ebb, unemployment has risen tremendously, and GNP per capita has declined in many of them. The overall debt of the South has reached unheard-of levels, approaching the $500 billion mark. Most of the developing countries, and especially the poorest among them, see their hopes for progress collapse, and they face a bleak future.

There are now some hesitant signs of recovery in certain industrialized countries. But this trend appears to be only a temporary one. Investment in these countries is

still sluggish, and business confidence remains badly shaken. In addition, the countries of the North continue to diverge on such crucial issues as monetary and fiscal policies, budget deficits, interest rates and exchange rate stability. Moreover, even if a successful coordination among them were to be achieved, it is doubtful whether recovery in a few industrialized countries would be sufficient to pull the world economy out of its present situation, since the precondition to assure a sustained world recovery, namely participation of the developing countries in theb Welcome address at the inaugural session of the Istanbul Roundtable. process, still seems to be a remote prospect.

The origin of the present crisis may be traced back to the collapse of the Bretton Woods system in the early 1970s. When this was compounded by the first oil shock, inflation went rapidly out of control, and when governments resorted to correspondingly severe austerity measures, a global recession, also reversing the trend to liberalize trade, was triggered. We seem now to have reached a point where-as affirmed by the OECD-the risks of continued retrenchment of the world economy exceed the risks of a renewal of inflation.

How do we get out of this impasse? Today's problems are so serious that they cannot be tackled by the ad hoc and palliative measures of recent years. They require fundamental and long-term solutions based on the reality of the interdependence of the North and the South, as well as on a concerted approach to the related issues of protectionism, disinflation and debt.

First and foremost, any strategy for surmounting the crisis must take into account fully the role of the developing countries as full partners in world development. The close links between the economies of the developed countries and those of the developing countries have been highlighted by the events of the past years. In particular, the financial bonds that join banks in the industrialized countries and borrowers in the developing world come to mind. We are now at a point where developing countries, through a defaulting of their debts could threaten the economies of industrialized nations and endanger the present world economic system.

Since the second oil shock, many developing countries have embarked upon balance-of-payments adjustment programs and have introduced far-reaching policy reforms aimed at domestic stability and export-led moderate growth. But such policies and efforts, however sustained and consistent they may be, are limited and thwarted by the adverse global environment. Today's world econoSe climate is even less conducive to developing countries' growth and to the maintenance of their debt servicing capacity than that which existed a few years ago. These countries are directly affected by the continuing weakness of economic activity in the industrialized countries, as well as by the wildly fluctuating exchange rates and interest rates. They are squeezed between stagnating and even declining foreign exchange earnings and soaring interest payments on their debt. I submit that the persistence of such a situation in the South is bound to undermine the pace of an eventual recovery in the North, by way of a delayed boomerang effect. Therefore, although the developing countries' own efforts are an important element in the world recovery, the main responsibility rests with the international community and especially with the industrialized countries bearing a decisive weight in the management of the world economy.

In this context, my country's experience might have some relevance. Turkey has been implementing a comprehensive economic stabilization program since 1980. This program was the first of its kind initiated by a developing country after the first oil shock. Emphasis on restrictive monetary, fiscal and income policies, coupled with flexible exchange rates and market rates of interest, as well as a greater reliance on market forces and the opening up of the economy to the outside world constitute the core of this program. The considerable progress achieved by Turkey, thanks to a rigorous implementation of these policies, is well-known. Within a period of only three years, inflation was brought down from a triple digit figure to around 25 per cent; our exports doubled during the same

period; our current account deficit was considerably reduced; and our rate of growth increased from negative I.I per cent in 1960 to positive 11.4 per cent in 1982.

However, while we have been striving hard to bring order into our economy and carry out the adjustment program, the deteriorating international economic environment has greatly hampered our efforts and considerably increased the exceptionally heavy burdens of adjustment. We had to face enormous difficulties in restructuring our industries while our major trading partners were defending their own, and in liberalizing our trade while facing increasingly protected markets. The gradual opening up of our economy to the outside world exposed it to a greater degree to the prevailing adverse external conditions. And, at present, the protracted recession which has also caused the contraction of the Middle Eastern market where we had gained access, has started to take an increasingly heavy toll on our adjustment efforts.

The recovery and the reactivation of the development process in the developing countries cannot be ensured automatically by an eventual upturn in the economies of the industrialized countries, which may at best yield its results in the medium term. However, developing countries do bear the consequences of a deflationary adjustment, and they run the risk of being side-tracked in the course of recovery. Thus, only an integrated set of policies implemented in a coordinated manner may lead to a really sustained and global world recovery. Such policies should include short-term measures in areas of critical importance to the developing countries in particular, as well as long-term changes in the world trade and monetary order.

The transfer of substantial financial resources to the developing countries, to enable them to increase their imports and accelerate their growth, is one area which needs immediate attention, since the existing structure of capital flows falls short of the balance-ofpayment requirements of most of these countries. The volume of development assistance has remained at about the same level in nominal terms for several years, representing a substantial decline in real terms. In fact, net financial flows from developed countries to developing countries are estimated to have decreased by at least 25 per cent between 1981 and 1983. The increases in IMF quotas and in GAB resources are belated attempts which have not yet borne fruit. Lending by private banks has slowed down, due to the overexposure of the system because of the well-known developments in Latin America, in particular.

As far as the poorest countries are concerned, an increase in the level of official concessional aid should be given the highest priority, since these countries are unable to maintain even absolute minimum standards without such assistance.

We must also remember that the flow of resources to developing countries is not enough by itself. Unless such flows are accompanied by a corresponding increase in trade opportunities, namely access to industrialized country markets, the participation of developing countries in the recovery process will fail to materialize, and their debt problems will inevitably worsen. It is obvious that protectionism and financial dislocation feed each other, creating a vicious circle. The accumulation of restrictions on international trade over many years not only poses a threat to the multilateral and open trading system, but also creates a more immediate danger of triggering a severe disturbance in the already jeopardized international financial and monetary system. Hence, industrialized countries must realize that it is also in their own interest to stop protectionist practices and gradually roll them back, while embarking upon accelerated structural adjustment programs.

In view of the present serious flaws in international economic management, it appears that short- and medium-term measures, a few of which I have tried to suggest, may not be sufficient to revert to sustained global growth conditions. We also need to develop a coordinated set of policies to govern international trade and payments in the longer term.

In particular, an overhaul of the international financial and monetary system appears to be the prerequisite to world economic recovery and stability. To this

end, a stronger, institutionalized cooperation between governments, central banks and the private banking community needs to be established. The IMF must also be strengthened, in terms of funding as well as in terms of acquiring a more effective influence on surplus and deficit countries, while adopting more realistic, selective and flexible terms of conditionality. In this context. Turkey welcomes the proposals for a Conference on Money and Finance, or as it is sometimes called, a "New Breton Woods." Such a meeting may be very useful in bringing about medium- and long-term solutions to the problems faced by the world economy. We also hope that, in the meantime, short-term measures to ease the present pressures will be adopted and effectively carried out. We are happy to note that a certain convergence of views between the North and the South has started to emerge in international flora. What is needed now is the political will to convert ideas into action. We believe that one way to speed up the process of creating the necessary political will is to debate major world economic issues at informal international gatherings such as this one, adopting an objective approach without political and economic prejudices.

The presence of so many eminent personalities, including policy makers at the highest level, high officials of international institutions and influential members of the business and banking community, gathered here at the Istanbul Roundtable will certainly ensure that this particular meeting will provide one of the most effective contributions to the aforesaid process.

## CHAPTER 4
## A Perspective on the Current Crisis
**Jean Ripert**

Monetary and financial problems are generally manifestations of underlying economic trends, and so it is important to situate money and finance issues in a larger framework. Therefore, let me begin by recapitulating the broad analysis and policy orientations that the Secretary-General of the U.N. and I have recently put forward both at the sixth session of UNCTAD and at the summer lesion of the Economic and Social Council.

Our basic observation is that the world economy continues to be in serious difficulty, and the developing countries feel the worst impact of it. One can take satisfaction from the recovery, even a strong recovery, that is now entering its third quarter in the United States. However, the situation is less bright in other parts of the industrialized world. The World Bank's latest Development Report refers to "a pervading sense of uncertainty," an uncertainty particularly concerning the durability and the geographical spread of the recovery process.

It would be erroneous to expect that a recovery in the OECD regions alone would solve all the problems that have been accumulating. In any event it will be some time before the benefits of the recovery in the industrialized countries are felt in the developing world. This is primarily because, as the United Nations World Economic Survey points out, the transmission of growth from the developed to the developing countries is increasingly viscous, especially in its trade component. While commodity prices have begun to rise modestly, it should be remembered that they are rising from a depth unprecedented in the post-war period. Protectionist pressures continue to be strong; some would say they are mounting. Given the widespread concern about unemployment, especially but not only in Europe, it will be some time before merchandise trade recovers its vigor. This is corroborated by the analyses coming out of GATT and other institutions.

These conditions add to the anxiety that surrounds a difficult monetary and financial situation. It is important to distinguish the two. In the monetary sphere, the instability in exchange rates, partly due to the speculative movement of funds, is hampering international transactions, both trade and investments. We are all

aware of the problems on the financial side: we are witnessing the second wave of debt problems; high interest rates are aggravating the debt burden; and no less an authority than Mr. Witteveen has recently reminded us that "the debt problem is unlikely to be solved until the end of this decade." The weak increase in concessional finance is not improving the prospects of the low-income nations in particular, and is adding to the serious difficulties of African countries.

However, the situation is not all somber, and it is important to recognize the bright spots where they exist. The fight against inflation in the industrialized countries has at last paid off, even though the cost has been high. The continuing moderation in the price of oil has certainly helped oil-importing countries, though it has created problems for the exporters. Despite all the protectionist pressures, world trade has not collapsed. The overall situation in Asia, particularly in the domain of food and agriculture, is satisfactory, holding lessons for other parts of the Third World.

On the political front, there is at the highest levels of government a growing awareness of the interdependence among national economies, as evidenced in New Delhi and Williamsburg. However, this enhanced awareness is so far not matched by measures to manage and orient the interdependence towards clear international goals, such as an accelerated development of developing countries. Multilateral cooperation, which has been a cornerstone of post-war growth and development, has not been strengthened in recent years to integrate the notion of interdependence.

In this overall framework, we in the United Nations have recommended four directions for action.

Firstly, there is an urgent need to improve the short-terYi financial situation of developing countries. This implies greater and more liberal access to balance-of-payments funds in order to strengthen their import capacity in the immediate future. Positive decisions on the level of access to IMF resources as well as on a new issue of SDRs will be of great help, both directly and by encouraging commercial banks to be more forthcoming. This is important for all developing countries, whether or not they have large and acute debt problems. Similarly, concessional finance-particularly swiftly disbursable funds-must be increased immediately, especially to lowincome countries which cannot afford high-cost commercial finance. Measures in the trade and commodities areas to augment and stabilize developing countries' export earnings are also important. For example, the Common Fund should be activated at the earliest possible time.

Secondly, these measures should be taken as part of a global and concerted effort for world economic recovery and development. The Williamsburg Declaration referred to the need to consolidate and spread the effects of the recovery. This would require closer intergovernmental cooperation, especially to bring down interest rates, stabilize exchange rates and restrain protectionist pressures. While many of these objectives are reflected in the conclusions of Williamsburg, the subsequent actions of governments regrettably do not add credibility to the pledges made then.

Thirdly, since international measures are no substitute for national measures, it is essential that domestic adjustment policies continue as a complement to the international action. Developing countries in particular have already taken draconian measures of adjustment, as is illustrated by the remarkable retrenchment in imports. The key issue is how to continue such adjustment without unduly compromising growth and development. Let us hope that it will not take dramatic events before the need to reconcile these dual objectives is sufficiently recognized by all parties, including key multilateral financial institutions.

Lastly, the urgency of dealing with the immediate situation should not obscure the need for longer-term measures to reform key aspects of international economic relations in the fields of trade, money and finance. One may take heart from the increasing awareness in some industrialized countries of the need for basic monetary reform. However, such awareness is not widespread enough. The United States, in particular, is far from convinced that important reforms are

needed.

Efforts to attack the problems I have just raised are being made within the United Nations and in other flora. Our meeting takes place in the shadow of the most important single event this year on North South issues, namely the sixth session of UNCTAD (June 1983). The results of the Belgrade meeting were not commensurate with the gravity and the needs of the situation, but encouragement can be taken from the serious and non-confrontational discussions which took place at the meeting. The important thing is to build on the results achieved at Belgrade, however modest, and to move ahead.

There should be a continuity between the sixth session of UNCTAD and other forthcoming opportunities for progress. I would mention in particular the September 1983 meetings of the Bank and the Fund.

The General Assembly of the United Nations will address these issues, as well as the question of launching Global Negotiations. The proposal has been o n the table for four years now, but the Non Aligned who first initiated the idea have now suggested a more flexible approach. They have also suggested an international conference on money and finance for development. There has also been a useful proposal by the Committee for Development Planning to set up a group of experts to examine the proposals for reforms in money, finance and trade, and connected issues.

Finally, let me make a few personal reflections. Proposals for change and reform are not very difficult to formulate. In my view, the world of concepts and ideas has moved more rapidly than the world of politics. We must admit that the predominant political and economic climate today in the major industrialized countries is not exactly propitious for reform and structural change. There is a renewed faith in the potential of price signals, market forces and individual entrepreneurship, at the expense, one could say, of governmental intervention and intergovernmental cooperation. A strong and sustained recovery in the United States will greatly vindicate those who subscribe to the liberal philosophy.

I believe the time has come for people like us to come up with adequate responses to this current thinking. The issues are not debated solely at the theoretical level; the industrialized countries have to be convinced politically too. They need to be assured that domestic resources in developing countries are fully mobilized, that adequate incentives are being given to channel entrepreneurship into productive sectors in those countries. They need to be convinced that management is being improved in the developing countries, that productivity is an important consideration in the policies of these countries, and that state intervention in the developing countries is compatible with these objectives. I believe that broadening the discussion on development in this direction will immensely strengthen developing countries’ case for international reforms.

This is relevant to the problem of aid fatigue we are witnessing in the North. At a time when the need for aid has never been greater, aid has not increased significantly. At a time when perceptions of interdependence have grown, we have not succeeded in inducing the richer countries to be more forthcoming. This should raise important questions in our minds. Are we sure, for example, that we take enough trouble to address all those interests and institutions in the North that are influential on aid? Have we reached out sufficiently to the legislatures, the business groups, the unions in the rich countries to convince them of the need for aid? Have we defined carefully enough the concept of interdependence, especially when it comes to reconciling different interests in the North? 1 do not believe we have. Neither have we in the U.N. organizations convinced aid givers and public opinion in donor countries that the maximum effort is being made to streamline the machinery for delivering aid, that aid goes to the really needy, and that it does not simply uphold antiquated bureaucratic structures.

There is also the important question of economic cooperation among developing countries. I believe the global economic crisis has been a valuable opportunity to the developing countries to strengthen ECDC. At a time when North-South

relations are beset with serious problems, the case for intensifying South-South cooperation is greatly enhanced. Yet little strengthening of ECDC has been effected in the past decade. I am aware that many meetings have been held and resolutions adopted on ECDC, but in terms of concrete achievements we have to admit that progress has been lacking. Multilateral institutions too, including the United Nations, need to face up to the challenges of ECDC.

More generally, I believe that those preoccupied with development and international cooperation have been very active in defining goals, especially for basic reforms, but have been somewhat less energetic in defining the means to those ends. Let me give an example. There is a consensus among many development economists that the monetary system needs reform. There is much consensus among the developing countries even on the kind of new system needed. But the steps to a reformed system are not adequately defined, particularly in terms of reconciling the differing interests involved in any reform process. I do not believe that the monetary system can be changed at one fell swoop. It will have to be reformed in an evolutionary manner. Yet we do not even have a consensus on the nature of that evolution.

# CHAPTER 5
# Perspectives: Crisis and Opportunity

The following are excerpts from some of the plenary presentations at the inaugural session of the Istanbul Roundtable.—Ed.

## Cesar Virata

Since the major debt crisis shook the financial world a year ago, a number of debt rescheduling operations have been necessary, even as economic recovery in the industrialized countries has gained momentum. Regrettably, before the current upturn, deflationary policies were pursued unevenly and prolonged stubbornly. Consequently, commodity prices collapsed and interest rates escalated. The erosion of export earnings and higher debt cost aggravated the troubles of a number of developing countries already burdened by accumulated debts. For some, the balance-of-payments situation became unsustainable, since a contracting capital market, shrunken by the dwindling of OPEC surpluses and by defensive curtailment of loans, made new financing unavailable. The reduced level of financing has depressed growth activities of these countries and has imposed a drag on world economic recovery, with the possibility even of aborting that process. And adjustment programs recently instigated by the IMF in recipient countries have been drastic and regressive.

Thus the events of the past years have brought a number of issues into the limelight: the growing debt problem, compounded by the contraction of the capital market and hardening of financial terms; the need for international policy coordination, to promote the broader international interest; constraints on international liquidity, and the need to pursue SDR allocations and other means for increased liquidity; and problems associated with IMF conditionality, which has

become more severe and unrealistic, partly because of the constraints on resources. These are the issues for which we must now seek answers. And we must determine whether these issues can be dealt with within the existing institutional structure, or whether they will require what might be called a Second Breton Woods.

**Bradford Morse**

I cannot tell you how gratified I am that this body has seen fit to include the examination of the vital but neglected ingredient of human resource development in your deliberations. The failure of the international community to provide support to developing countries for human resource development is in fact one of the causes of the situation in which the world finds itself today. And perhaps the reversal of this neglect can provide a partial cure for those vast difficulties.

Now there can be no doubt that the world faces a situation approaching catastrophic dimensions. We have seen the gradual decline in the volume of world trade, prompted by the worldwide recession. We have seen the collapse of primary commodity prices beginning three years ago, accompanied by increases in the price of manufactured goods imported by developing countries. We have seen a precipitous rise in interest rates and the associated fluctuations of exchange rates, and we have seen the growth of protectionism among developed market economies. And the impact of all these external circumstances has affected almost all developing countries, in varying degrees. To some extent, virtually all countries have faced import reductions resulting from declining foreign exchange earnings; reduced inflows of external capital and rising debt service requirements; falling government revenues because of declining economic activity and trade stagnation; reduced investment plans and a slowdown of ongoing capital projects; cutbacks in spending on long-term human resource development; shortages of funds to finance the operation and maintenance of existing facilities and institutions.

Without additional capital to support real adjustment, debt restructuring may serve neither the aim of an ultimate restoration of countries' creditworthiness nor the long-term purposes of development. But perhaps more than capital, what is needed is human capital, without which it will not be possible for developing countries to maintain, to sustain, and to maximize the value of the investments made in them. As the World Development Report for 1983 states, "over the long term the challenge for developing countries is to use their limited resources more efficiently and more equitably," and the report terms the enlistment of the skills and energies of the population at large as "perhaps the most important task of national economic management." Simon Kuznets, the Noble laureate, said in this connection that "ninety per cent of development in the past in the industrialized countries was due not to addition to capital but to improvements in man's capacity, skill, know-how, management, etc. Man's capacity, not capital, is the number one multiplying factor in the process of development."

The world has suffered in recent years for what one might call a Marshall Plan mentality. The Marshall Plan was not an exercise in development but rather an exercise to help restore economies which were ravaged by war-economies in which there was a strong human and institutional infrastructure and where the only requirement was the transfer of capital. But development is an entirely different process. The essential elements are development of human capacity and refinement of institutional structures. The Marshall Plan, which achieved such success, resulted from a vision-an articulated vision of the future-around which was built a strategy perhaps even more important that the financial resources invested in it. So too must the international community today define a strategy, identify an image of the future, if we are to find our way out of the woods, indeed, out of the Breton Woods.

**Maurice F. Strong**

The role of the private sector is now being widely acknowledged as indispensable to development. Of course, each society must define for itself how the private sector can operate to support and augment national development policies and objectives rather than undermine them. But it is very important that we abandon the sterile ideological clichés that so often accompany a dialogue on the private/public relationship, and which have immobilized the contributions that the private sector can make to national economies, in both developing and industrialized countries.

There are several vital aspects of this issue that we should address. One is the environment for private sector investment in developing countries, an environment which only the countries themselves can create, in response to national objectives. In most countries today, that environment is not adequately hospitable to increase the flows of private sector investment or to reap the benefits in technology and human resource development that accompany such investment.

A second aspect we must address is the need for increased flows of capital for development, which are not likely to be available from official sources nor from increases in private bank lending, and which must therefore be mobilized from new sources of private sector capital. The sources that must be tapped are largely those that are now active only very peripherally, such as pension funds, investment trusts, insurance company funds, and so on. In this way, private capital flows from banks can be balanced by flows of equity-related and long-term, fixed-rate capital. Of course, the sources of this new capital will need insurance on their investment or reasonable prospects of profitability. One possibility is a new private sector intermediary for evaluation and management of risks. New mechanisms for this could involve small, special-purpose organizations as well as larger operations such as a private Third World bank.

The developing-country recipients of investments also have an interest in ensuring that private capital comes to them under conditions that support and do not frustrate or constrain their own national policy objectives. They want capital to make an important contribution to jobs, to human resource development, and to the development of technological capabilities. We must come to a new understanding of the essential role of the private sector, not only in terms of global initiatives, but in terms of strengthening each country's efforts to find the proper balance in its own policies between the private sector and the public need.

**Arthur Dunke!**

International trade should not be seen as an activity carried out by a limited number of specialists and taking place more or less on the margin of the national or international development process. Given the high degree of interdependence between national economies, trade policy has to be considered as an integral part of national and international economic policy. This is why we in the GATT have been analyzing very closely what role trade policy can play in the current efforts to sustain and expand the economic recovery which is now under way. Our preliminary findings show that, although the decline in world trade bottomed out near the end of 1982, fragmentary data for the first half of this year suggest that the level of trade was still below that of the first half of 1982. There are in fact no signs of the kind of vigorous expansion of trade that accompanied the recovery from the 1975 recession.

I can think of a number of reasons for this very unsatisfactory evolution. It seems, for example, that the upturn of the commodity prices and the related increments in export earnings which have taken place have mainly been used to insure the debt service, not to increase imports. U also appears evident to me that a number of trade restrictions introduced during the last years, often in breach of the GATT rules, are now going against an international transmission of the recovery. It is often precisely in the areas where the developing countries are in a position to expand their exports that these countries face the most severe

restrictions in the industrialized world. It seems as if we have lost the experience of the London bankers in the first half of the century, who knew so well that creditors have to import from their debtors in order to be repaid. It is high time for GATT contracting parties to consider the elimination of the restrictions which limit the role of trade in the spread of recovery. Such a move is not only necessary from the strict point of view of trade policy or of international division of labor; it is also urgently needed in order to recreate the climate of confidence in the absence of which new investments will not be made. Clear, predictable, liberal trade policies are one of the major prerequisites for an increased flow of financial resources for development.

**Enrique V. Iglesias**

Latin America has the very dubious privilege of being perhaps the most severely affected region in the present juncture. At the end of 1982, we thought that year would be recorded as the worst year in our recent economic history. But we were wrong; 1983 will be worse. The $320 billion external debt is said to be approaching $1,000 of debt per capita. Forty per cent of our exports this year will be devoted to paying interest on our accumulated debt. And we are this year becoming net exporters of capital-to the tune of $15 to 20 billion. We expect that we will have to live with this sort of mortgage for quite a few years to come.

The effects are welt known. Last year gross national product declined in several countries: IS per cent in Chile, 10 per cent in Uruguay, 6 per cent in Argentina, and so on. Of course there are social costs-some countries have unemployment figures of 25 or 30 per cent. We are reaching the limits of social and political tolerance.

Two questions must be asked: What happened? And what can we do?

When we analyze the facts of how this situation arose, we find three basic factors: (I) inappropriate internal policies; (2) external factors such as declining terms of trade, rising interest rates, and contraction of private capital flows; and (3) problems in the inter national monetary system.

As to the issue of what is to be done, first it should be noted that the Latin American countries have adopted serious adjustment measures, in coordination with the imaginative efforts of the IMF to maintain a flow of finance from the private sector. And there is an assumption that the problems will be solved automatically when the world recovery comes about. However, many of us have certain doubts. How long can we wait for the benefits of recovery? What about the continuing rise of interest rates? Can recovery take off in a situation where every country is advised to export more and import less? And is the present adjustment process not putting too much of the burden on debtors, with more and more charges imposed for the rescheduling of debts? Finally, can we expect a real change in trade policies, which is a prerequisite for the solution of our debt troubles?

In Latin America there is a new interest in discussing these issues collectively. The heads of state are considering meeting to address two issues: What sort of responsible solution can we seek from the international community to improve the present environment? And what can we do as a region? This is perhaps one positive outcome of the present crisis-a new acknowledgement that regional cooperation in Latin America is something that should be promoted and developed.

**James P. Grant**

We have heard from the speakers today that we are meeting at a time of great crisis. We should remember, history has established that it is crises that provide the stimulus to major new developments. Certainly that is what happened with Bretton Woods and the Marshall Plan, which would not have occurred but for the

crises that preceded them. And the New Deal of the 1930s in the United States would not have come about without the Great Depression. Even here in Turkey, the Green Revolution that swept through this country in the late '60s and '70s would not have taken place without the food production problems and population explosion that caused a new sense of urgency. But it is very clear, too, that if one is to turn crisis into opportunity, one must know what to do. It is for that purpose that we have come together at this conference.

# PART II

# EXTERNAL DEBT AND THE LDCs

"Despite the difficulties and uncertainties, I believe that international lending to developing countries will continue to expand substantially. This judgment ... is based on an awareness of the underlying conditions and needs in countries which have two-thirds of the inhabitants of our world .. ."

Irving S. Friedman

## CHAPTER 6

## An Overview*

**Khadija Haq**

The early $0s will be remembered by future historians, economists, and leaders as a time when the concept of interdependence of nations took on a grave new meaning, a meaning imbued with the threat of world economic collapse. Even now, the threat can become a reality through defaults by just a few developing countries on their massive external debts. Under these portentous circumstances, the participants at the Istanbul Roundtable addressed the subject of external debt with a great sense of urgency. The discussion in the workshop on external debt embraced both the diagnosis and implications of the situation and proposals for its solution. Opinions were heard from all parties-from the private financial sector of the developed countries, from ministries of the developing world, from the major international institutions and from academia. In the Roundtable spirit of dialogue, all participants clarified their individual stances and own analyses, considered the analyses and proposals of others, and sought areas for possible consensus, which might hold promise for concrete progress in official arenas. What follows is a brief account of discussion that took place.

### DIAGNOSIS AND IMPLICATIONS OF THE DEBT CRISIS

The situations of many developing countries in the throes of debt crises can be viewed either as the bitter fruit of years of compounded errors by borrowers and/or lenders, or as largely the unfortunate by-product of several coinciding events in the world economy. According to the first view, irresponsible and over-extended lending by the private commercial banks of the developed world to countries of the developing world throughout the 1970s has snowballed into an unsustainable burden of debt service. The crisis was years in the making and prudent bankers

should have anticipated it and put on the reins. Additionally, or alternatively, fault for the crisis lies with borrowing countries, whose financial and economic policies have amounted to bad management of the borrowed funds, with weak current account performance, overvalued exchange rates causing capital flight, high domestic inflation and import of consumer goods.

The other view, lifting most blame from the debt parties, points instead to a confluence of recent world trends-high interest rates, depressed commodity prices, volatile exchange rates, recession, rising trade barriers-as the explanation for the debt crisis. In the 1970s the steep rise in Third World debt to commercial banks was an inevitable but not in itself harmful movement. Commercial banks in industrialized countries had surplus funds, deposited by the OPEC, and the real rates of interest on external borrowing were very low or negative. So the developing countries used the opportunity to borrow in order to grow-and throughout the 70s the growth of the developing countries was very strong indeed. Then came the recession and with it unemployment, protectionism and monetarist policies in the developed countries; and adverse terms of trade, low commodity prices and high cost of borrowing for LDCs. Floating exchange rates added an additional volatility to an already unmanageable situation. Thus arose the debt crisis, at debt levels which could have been sustainable under "normal" economic conditions.

In either case the growth of Third World debt to private banks has a number of implications for the functioning of the world economy. Billions of dollars crossed international boundaries seeking shortterm commercial gains and, at times, compromising the long-term growth and stability of the world economy. Foreign commercial debts contracted at floating interest rates increased the burden of total stock of debt of developing countries when industrialized countries decided to raise their interest rates. It was estimated that a I per cent increase in interest rates increased [DC current account deficit by roughly $2 billion. Movement of liquidity, depending on private decisions, became erratic. Availability of bank financing also influenced some developed country governments' decisions to restrict concessional flows. And finally, the fact that much Third World debt was with private banks meant that the previous mechanisms for sharing the burden in times of difficulty could not be used. At the time of the debt crisis of the '30s, most of the international borrowing took place through issuance of national bonds, and the shifts in the bond market meant that the costs of recession were shared by both borrowers and lenders. In the current situation, no such sharing mechanism exists. Thus, as this catalog of implications shows, the current crisis is not due only to the magnitude of debts, but also to the new form of those debts and our brief experience with it.

The present situation is a Catch-22 for borrowers and lenders alike. With high interest rates, swelling debt-service payments have turned some developing countries into net exporters of capital, while high unemployment and falling standards of living reign at home. This is not a viable position; yet countries have no acceptable recourse, except the one which would close their future access to finance-default. The lenders' Catch-22 is the familiar "banker's dilemma"-they have loaned so much that they must support their stake by lending more. Most of the private banks are trying to reduce their exposure in the Third World; many of those with smaller interests are trying to withdraw entirely. New lending has fallen dramatically. Yet, though some lenders can afford to pull out singly, a mass retrenchment would destroy countries' ability to pay service on standing debts and trigger widespread default, which would bankrupt many major banks and shatter the world financial order.

In this situation-a grave one for both borrowing countries and lending banks-the International Monetary Fund is making bold efforts to coordinate a rescue, maintaining a flow of involuntary bank lending by threats to withdraw its own support, facilitating the renegotiation of debts between banks and countries, and imposing conditions of internal balance-of-payments adjustments on

the debtor countries. Although the international community generally applauds the 1MPs singular efforts, a number of cogent criticisms have been made. Some observers point out that the ad hoc quality of the IMF's approach-handling renegotiation on a country-by-country basis-ignores the aggregate results of the conditions imposed. In an individual case, a debtor country's restrictive policies may work to adjust balance-of-payments troubles by reducing imports, but a simultaneous application of this policy to a number of countries would result in a reduction of world demand and of world growth. From this analysis it can be concluded that restrictive adjustments by debtors alone will never resolve the debt problem satisfactorily, and that a new approach, involving creditor countries in the adjustment process, is required.

Another criticism directed at the IMF's tactics is that they constitute a bailing-out of the private banks. It is the debtor countries who are paying fully for the crisis, with continued high debt-service burdens and decreased inflows of capital, and with adjustment policies weighing heavily on their populations and creating political instability. Meanwhile, banks continue to receive their payments, even gaining windfalls from penalties charged for late payment. That the burdens of adjustment are not shared by both parties is seen by many as a great inequity, though some excuse it on the ground that the borrowing countries voluntarily took on the risk in their debt contracts. And to throw a share of the burden onto the lending banks now would threaten future supplies of credit; and that must be avoided at all costs.

Thus, the focus of the IMP at present is to keep the major players in the international lending game. Of course, involuntary lending is an emergency measure which cannot be maintained for long nor resorted to soon again. So the pressing questions now are these: Where will the future financing for Third World growth come from? Will there be a resumption of private bank lending or will new sources of finance have to be found? Does the developed world's presumable recovery hold the key to the debt problem, or are improved LDC policies the answer?

## PROPOSED SOLUTIONS

Various ideas were put on the table in a search for resolution of the current crisis, with discussion focusing specifically on world recovery, change in developed and developing country policies, institutional changes and increase in private sector flows to LDC5.

**(a) World recovery**. Those panelists who hold world recession responsible in playing a major part in the current debt crisis saw the world recovery as a way out. The scenario will look as follows: as the world emerges from recession, interest rates will fall, trade will pick up and the debt burden of developing countries will return to comfortable levels. Some recent projections were quoted: a 1 per cent increase in the growth rate of OECD countries would add $35 billion to the annual export earnings of the non-oil developing countries.

But others maintained that, while a thorough world economic recovery would no doubt benefit the debt-troubled countries, recovery alone is not a reliable solution. Some pointed to present conditions which augur against large new flows of capital: the developed countries now have no net savings and are net importers of capital. Others pointed to new restrictions on the export products of developing countries, which would dampen their benefits from world growth. The question also arose: Which countries will derive most benefit from growth-the big debtors or those more advantageously positioned? And world- recovery alone will not solve the structural problems-within developing countries and within the international institutions-which contributed to the present crisis. Finally, it was argued that world economic recovery is a slow process and the developing world, with its current costs in terms of enormous human and economic sacrifice,

cannot rely on this alone.

**(b) Policy changes in both developing and developed countries:** Developing countries' domestic adjustment policies involving realistic exchange rates, reduced trade restrictions and increased investment for human resource development were agreed upon by the panelists as key to any successful attempt to resolve the current crisis. These measures would generate confidence among international institutions and commercial lenders. Some carried this point further by arguing that as the borrowers would not be able to ride out the crisis if lenders retrenched more than they had already done, the LDCs, through their policies, must reassure the lenders that they would be protected from risks and penalties.

There was a strong objection to this view from the standpoint of equity, however. Protecting the banks means leaving the burdens of the debt crisis on the shoulders of the developing countries, and especially of their hard-pressed poor, who are already suffering from the harsh effects of the adjustment process. Not only does this approach seem inequitable, but it may backfire on the banks and IMF, since in many cases, the strains may not be endurable politically and may force governments to opt for default or moratoria. Therefore, it is right and necessary that the creditors carry their share _- 'c adjustment effort, accepting reduced profits on the existing loans. Furthermore, it was held that it was not only the debtor countries who must make policy adjustments; there was also a need for changes in policies of developed countries, where high interest rates, volatile exchange rates, and rising protectionism have made improvements in Third World balance-of-payments positions almost impossible to accomplish.

**(C) Institutional responses:** In the short run, an increase in the available resources of the international financial institutions would go a long way in sustaining the LDCs through this difficult period. In this context, it was suggested that a special issue of SDRs should be made for a major debt restructuring in order to eliminate the current debt overhang. But, since this measure would require a change in the IMPS Articles of Agreement, it was ruled out as a solution in the short run. More workable suggestions were: to create a new compensatory financing facility at the IMF to meet the burden of fluctuating interest rates; to increase the IMF resources immediately through an enlarged quota and GAB; to make the World Bank return to fixed interest rates; and to increase resources of the World Bank.

**(d) Private flows:** One of the issues now facing policy makers is what role the commercial banks, which are presently retrenching their Third World commitments, could and should play in the future. There was a range of projections on this issue, though most analysts agreed that there will not be a return to the swift growth of private lending seen in the 1970s. Given the recent success of the IMF in maintaining a flow of commercial lending, and assuming there are no massive defaults by debtors, it seems likely that banks will gradually increase their lending to its pre-crisis level and thus will continue to be important players in the game of Third World finance. However, the debt crisis will have left its mark on the behavior of lenders and borrowers alike. In the absence of the vast new financial flows of the 1970s, developing countries will need to improve their economic and financial management and reestablish their creditworthiness. Bankers will likely judge risks more cautiously. And both will seek ways to reduce their risks.

A number of proposals were floated to increase private sector lending to developing countries. These were: development of equity investments (e.g., by Third World investment trusts), introducing new types of bonds (e.g., commodity-linked bonds, index-line Ed bonds), and the development of secondary markets in bank loans. These measures would extend the source of borrowing to institutional lenders and others not now lending to developing countries.

From the lenders' point of view, a country-by-country risk evaluation system by

a new private sector institution seemed to be of utmost importance to stabilize private flows. Toward that end some thirty U.S. banks have set up the Institute for International Finance where Third World country credit ratings are developed and disseminated. The participants agreed, however, taht there must be a new or reformed public institution to coordinate private decisions and country-by-country negotiations.

Even with an improved lending atmosphere and a resumption of lending by commercial banks, the resources from traditional financing sources are unlikely to permit the kind of steady growth experienced in the Third World in the '60s and 70s. As mentioned earlier, one implication of the increase in private finance in the '70s was a decreasing emphasis on aid, which is unlikely to regain its old predominance. For a return to stable development, additional resources will be needed, and new sources of finance must be sought. Some of the ideas that were put forward in the workshop are elaborated in the chapters that follow.

# CHAPTER 7
# The International Debt Crisis
**Irving Friedman**

## INTRODUCTION

The external debt of the developing countries has moved to the forefront of international attention. For decades a matter of concern only for those few involved with economic and social development and its financing, the subject has now captured the imagination of commentators, novelists and politicians. External debt of developing countries is seen as an explosive volcano, threatening the world economy and world finance. It is regarded by many as an outcome of lenders' folly and greed or of borrowers' irresponsibility and stupidity. These emotional stirrings threaten to become the basis for decisions by private and public policy makers-decisions which would last a long time and threaten the economic development of the developing countries, already severely handicapped. The danger is expressed in the old adage of "throwing out the baby with the bath."

There are important lessons to be learned from our recent experience. Improvements can and should be made in international borrowing by developing countries and in lending to them by private and public entities. Such improvements must be guided by careful and thoughtful evaluations. We must be aware that the developing countries require major sources of external finance and that these needs will steadily increase in the years ahead. Developing countries can restrain growth; but they can do so only for relatively short periods if restraints mean more unemployment or reduced living standards. External financing creates the possibility of more jobs, more investment and higher living standards in countries desperately in need of all three. Unless we have plans for the expansion and alteration of public institutions to meet the needs of developing countries, we must be wary of suggestions to weaken the capability of private lenders without finding substitute sources of financing appropriate in terms of time, magnitude, and purpose. Assertions about risks and losses must be examined in light of available facts and experience. In any case, ways and means must be found to improve the ability of existing private institutions to perform their vital function of development finance in a manner appropriate to their private character, in a world of large debts and adverse economic conditions.

## BALANCE OF PAYMENTS DEFICITS AND NEEDS FOR EXTERNAL FINANCING

Modern developing countries are committed to accelerating economic growth and structural transformations, such as expanding modern manufacturing and

agriculture and miniaturizing traditional barter societies. And other closely related social objectives for improving the quality of life require capital expenditures for such things as schools, hospitals and recreational facilities. Moreover, many developing countries are required to subsidize food and housing, which reduces available savings for investment. The question of the merits of these social policies aside, they create economies that are usually in deficit and often characterized by chronic inflation-even in countries making strong efforts to increase domestic savings.

These deficits can be expressed in real terms such as gaps in goods, services and technology, or in money terms such as savings/investment gaps and balance-of-payments deficits. However expressed, such gaps can be filled in the short run only by inflows of goods and services or of financial resources, whether in the form of grants, concessional loans, or credit extended by private capital markets on commercial terms.

At any given time, the developing economy can do only what available resources permit. "Gaps" exist in the future; actuality eliminates these gaps. But how the gaps are eliminated is a prime determinant in the development process. Too often, inflation has been the adjusting mechanism, itself creating serious problems by discouraging savings and encouraging nonproductive use of resources and by producing inequities in income distribution and consumption. Devaluation of the national currency can help such countries reduce the need for external financing, but by itself cannot bring in needed additional resources nor assure their efficient productive use. Beneficial results depend on the entire package of government policies put together and effectively implemented by the developing country.

Chronic balance-of-payments deficits can be financed either by inflows of grants (gifts) from external donors or by debt and equity capital. Short-run forecasts of such external deficits can be made, external financing needs can be estimated, and alternative responses considered. An alternative to external financing of such anticipated deficits is the adoption of restrictive domestic monetary and fiscal policies and exchange rate adjustments, with or without external restrictions on trade or payments. Such polices will result in a marked reduction in domestic investment or consumption and , in due course, in a reduction in balance-of-payments deficits. Balance-of-payment deficits of significant magnitute are normal and by themselves do not signify domes or balance-of-payments mis-management. They do required financing .if they are not financed, the country must either use its international monetary reserves, if available, or draw on its production or stock of goods to reduce the need for imports. In development countries, such alternative are few, limited in scope, or slow in materializing. Thus, for developing countries, the interrelation between demestic conditions and balance-of-payments developments is particularly strong, as is the impact of international changes on the natoinal balance of payment.

Governments of developing countries must be constantly vigilant about domestic and external problems, particularly ablut such international development as increases in the cosr of eddentioal imports or declines in world market prices for major export commodities. Unexpected adversities can inflate a countrys impor bill, while worldwide economic recession or strong protectionism in market countries can create unanticipated declines in export earnings, bringing additional strains into already deficult economic adjustment periods. Often, the freedom of a government to deal with such adversities is limited by the government's prior commitment to certain socil policies and the given consumption and investment levels. Conditionas csn be aggravated when an erosion in citizens' confidence in their government and its economic polices ( such as its willingness or ability to have a realistic exchange rate) leads to capital flight.

The use of past saving in the form of internatinal momnetary reserves can ameliorate adjustment problems. Reserves can finance a net inflow of resources from abread , but rarely does a developing country have international reserves large

enough to substitute for new inflow of capotal for a substantial period of time. Borrowing externally to increase reservation, as has been done frequently, may be useful but creates other problems. The increased external debt is a charge against future earnings, and in the long run the country's position is not fundamentally improved. Increase short-term liquid assets are offset by increased liabillities, since reserves are not saving form past surpluses to meet future coningencies. There may, however, be other benefits from such borrowing policies, such as helping to improve creditworthiness. Countries like Brazil and Mexico have repeatedly borrowed to increase reserves, but these reserves do not reflect a surplus economy, as does international reserve accumulation in Germany or Saudi Arabia.

The basic structural characteristics of developing countries-low output, inadequate productive facilities, poor infrastructure, widespread unemployment and underemployment, poverty, etc.-explain why the Third World, ever since the end of World War II, has been a constant large borrower from foreign sources as well as a recipient of equity capital and large grants. Over the past four decades, the industrialized nations have assisted the developing countries in their efforts to accelerate growth and modernize their economies, by large transfers of resources. Initially, grant aid was the principal form of transfer, particularly to former British, French and Dutch colonies emerging into independent nationhood. Such grant assistance continues to be important for the poorer and the poorest of the developing countries. Major donor governments, however, have preferred concessional loans to grants. Such loans have been extended by the member countries of the Development Assistance Committee of the OECD, on a bilateral or multilateral basis, by the multinational and regional development banks, and by other official institutions in creditor countries.

At the same time, an increasing number of developing countries have been creating the conditions to borrow commercially, first through supplier and other export credits, often guaranteed by official agencies in the industrialized countries, and then directly from private commercial banks and other financial institutions without guarantees. Indeed, by the late 1960s, debt owed by developing countries to private lenders was already growing more rapidly than debt to official lenders.

## EXTERNAL SOURCES OF FUNDS AND BORROWINGS

Private commercial banks lending is proving crucial to the social and economic evolution of many developing countries. This source of financing enabled the process of modernization and growth to maintain its momentum in the 1970s, despite the severe shocks of geometric rises in oil prices, large increases in balance-of-payments deficits, accelerating persistent inflation, restrained growth in developed countries, and increasingly severe global recessions.

In the early 1980s, conditions worsened. Global depression replaced recession, but persistent inflation continued, though at lowered rates in a number of industrialized countries, particularly the United States. Developing countries began to experience difficulties in servicing their external debts in the 1970s and into the 1980s. Table I gives the order of magnitudes of net flows of financial resources, from all sources, to the developing countries. According to these statistics, commercial bank lending to developing countries, excluding bond lending and export credits (which are mostly guaranteed by creditor governments or government agencies), increased from $3.3 billion in 1971 to about $25 billion in $981. This represents an almost eightfold increase over a ten-year period. By comparison, total net receipts of financial resources, including grants, concessional loans and direct investment, increased from $21 billion in 1971 to $104 billion in 1981; this represents a fivefold increase over the same period. With private export credits and bond lending added to bank loans, the net receipts of developing countries from these sources amounted to $6.3 billion in 1971, or less than 30 per cent of total net receipts of that year. In 1981, however, bank loans, private export credits

and bond lending totaled $38 billion and accounted far 36 per cent of total net receipts. The growth in syndicated bank credits and in international bond lending to developing countries since the early 1970s is also shown in table 2. For example, syndicated bank credits to developing countries in 1982 alone exceeded by $11 billion the combined total for the five-year period 1971-75 and accounted for almost half of all syndicated bank credits extended worldwide in that year. International bond lending at fixed interest rates to developing countries is much smaller by comparison and in 1982 accounted for only 6 per cent of the world total. If private commercial lenders restrain their lending to developing countries, borrowing countries will lose a vital option in pursuing their development objectives. The existence of this option for developing countries to borrow from private commercial lenders is, however, still fragile and vulnerable. Private lending to developing countries is still largely novel for both borrowers and lenders; it has not established deep roots in the international financial communities to withstand strong adversity without causing widespread concern. Confidence is essential for creditworthiness. But many of the borrowing countries are relatively new nations; some have relied in the past nearly exclusively on official sources of development finance; and

TABLE 2

Syndicated Bank Credits to Developing Countries, 1971-82
Billion U.S. Dollars

| Group | 1971-75 | 1976-80 | 1980 | 1981 | 1982 |
|---|---|---|---|---|---|
| Non-Oil Developing Countries | 214 | $09.9 | 24,0 | 33.4 | 28.3 |
| OPEC | 8.0 | 45.1 | 11.0 | $1.9 | 12.5 |
| All Developing Countries | 29.4 | $55.0 | 35.1 | 45.2 | 40.8 |
| World Total | 83.2 | 299.6 | 77.4 | 133.3 | 84.2 |

Fixed-Rate International Bonds for Developing Countries, 1971-82
Billion 0.S. Dollars

| Crud | 1971-75 | 1976-80 | 1980 | 1981 | 1982 |
|---|---|---|---|---|---|
| Non-Oil Developing Countries | 1.9 | II.5 | t9 | 43 | 3.9 |
| OPEC | | 3.5 | 0.5 | 0.4 | I.0 |
| All Developing Countries | 3.2 | 15.0 | 2.5 | 4.8 | 4.9 |
| World Total | 50.3 | 181.9 | 41.9 | 53.0 | 75.8 |

Source: Morgan Guaranty Trust, World Financial Markers, various issues.

Others have experienced difficulties in servicing their external debt to official and private lenders. Borrowers, lenders, and scholars all recall the troubles of the Great Depression of the 1930s, and the widespread financial crises spawned by a world economy that could not find its way off the road to disaster and back to prosperity.

A further complication comes from the widespread misunderstanding of the lending policies and lending capabilities of commercial banks. Lenders are often portrayed as short-sighted and driven by market forces to make loans even to the point of imperiling their own institutions. Competition, it is argued, forces them to make poor decisions. From another perspective, it is often argued that if lending serves to make attractive profits for the lender, it must be undesirable, unfortunate, or even harmful to the borrower! Thus, in the 1970s and even more today, international lending to developing countries has been widely criticized as dangerous to lenders and undesirable for borrowers. By contrast, in the 1950s and ‘60s, maximizing

the availability of private sources of external finance to developing countries was regarded as helpful, as long as the financial terms and use ofthe funds were acceptable to the borrowing country.

A given magnitude of concessional assistance finances a larger net inflow of real resources than does finance obtained on commercial terms. And the higher interest costs of commercial borrowing are paid in real goods and services. However, this obscures the fundamental point that in practice these are not truly alternatives. The volume of official development assistance has been and remains inadequate for the needs of developing countries. Developing countries do not borrow from private sources at high interest rates and short maturities because they wish to misuse the borrowed funds. Nor do countries borrow to avoid needed adjustments in economic management. Such accusations, however, have been made often by observers who enjoy wide publicity and credibility and whose views are therefore influential in forming public opinion on financial policies.

Countries borrow to pay for imports of consumption goods, intermediate and capital goods, and services, including payments of interest, dividends and royalties. In broad terms, imported resources supplement domestic resources; their usage reflects national usage of domestic output. However, they can alter the composition or relative proportion of consumption and investment; e.g., borrowing for investment projects tends to induce more investment relative to consumption of domestic output.

No feasible level of borrowing from private commercial banks can enable a country in balance-of-payments difficulties to avoid needed adjustments more than briefly. Bank lending may cushion or even delay, but not avoid the balance-of-payments adjustment process. The lending criteria of private commercial lenders, moreover, tend to induce changes in the macro-economic management of borrowing governments, though such changes are not by custom explicitly stipulated in loan contracts. The lending policies of private commercial lenders give much weight to the quality of economic management. Private loans to mismanaged, weak countries or for unproductive purposes are probably not fulfilling the lending standards that must guide a private lender. Such loans are mistakes, costly to lenders and borrowers-too costly to be countenanced for long or made frequently.

TABLE 3

Disbursed External Term Debt Outstanding in Developing Countries, 1971-82•

| | 1971 | 1975 | 1976 | 1977 | 1978 | 1979 | 1980 | PrN 1981 | Est 1932 |
|---|---|---|---|---|---|---|---|---|---|
| Total” | 90 | 11 | 220 | 274 | 345 | 406 | 465 | 530 | 626 |
| Source of Lending: I. DAC-ODA | 24 | 34 | 37 | 41 | 49 | 53 | 57 | 57 | 63 |
| 2. Multilateral | 10 | 22 | 26 | 33 | 40 | 47 | 56 | 65 | 76 |
| 3. Capital | 20 | 61 | 80 | 103 | 134 | 162 | 190 | 222 | 265 |
| Bank Loans | 11 | 49 | 64 | 81 | 105 | 131 | 155 | 150 | 210 |
| 4. Export Credits | 27 | 42 | 51 | 65 | 85 | 100 | 114 | 128 | 148 |
| 5, Other9 | | 21 | 26 | 32 | 37 | 44 | 48 | 58 | 74 |
| Percentages of Total Debt by Source of Lending | | | | | | | | 10,8 | 10.1 |
| I. DAC/ODA | 26.7 | ISS | 16,8 | 15.0 | 14.2 | 13.0 | 12.3 | | |
| 2, Multilateral | 11,1 | 12. | 11,8 | 12,0 | 11,6 | 11.6 | 12.0 | 12.3 | 12,1 |
| 3. Capital Markets | 22.2 | 33. | 36,4 | 37.6 | 38.8 | 39.9 | 409 | 41,9 | 42.3 |
| Bank Loans | 12.2 | 27.2 | 29.1 | 29.6 | 30.4 | 323 | 33,3 | 340 | 33.5 |
| 4, Exponcmdits | 30,0 | 23, | 23.2 | 23.7 | 24,6 | 24,6 | 24.5 | 24. | 23.6 |

| 5, Other | 10,0 | 11, 7 | 11 .B | 11.7 | 10,7 | 10,8 | 10.3 | 109 | 11.8 |
|---|---|---|---|---|---|---|---|---|---|
| Annual y Nominal Increase | (16) | (24) | (22) | 125) | 126) | (IB) | (15) | (14) | DB) |

• Approximately 150 developing countries including OPEC countries.
"• Includes external term debt whether public, publicly guaranteed or non-guaranteed
in the borrowing country,
^• Bank loans (other than export credits), including loans through offshore centers.
Bonds and other private lending.
Source: DECD, Development Co-operation, 1982 Regime, Paris, November 1982, and
OECD, Press Release, June 23, 1982.

## THE EMERGENCE OF THE EXTERNAL DEBT PROBLEM AND PROSPECTS FOR THE FUTURE

In order to put figures showing the magnitude of the external debt developing countries into better perspective, it is advisable to review the growth in these countries' external debts and debt servicing obligations over the past decade. a consequence of the sizable net flow of financial resources from the industriah'ied nations to the developing countries since the late 1960s, the total disbursed external term debt (i.e., debt exceeding one year in maturity) of the developing countries at year-end 1982 stood at about $625 billion, up by almost $100 billion from year-end 1981, and seven times the level at year-end 1971, when the outstanding debt amounted to about $90 billion. The total amount of the external term debt outstanding to banks (excluding private export credits) increased from $I I billion at year-end 1971 to $210 billion at year-end 1982; this represents an almost twentyfold increase over the period. Most of this debt was on a floating rate basis. In addition to these bank loans, through which the banks are at direct risk, officially guaranteed export credits, which at year-end 1971 amounted to $27 billion, had grown to $148 billion by 1982. Moreover, external term debt owed to private lenders other than commercial banks, but including bond lending, increased from $9 billion at year-end 1971 to $55 billion at year-end 1982. (See table 3.)

Commensurate with the growth in the outstanding external debt and with the sharp rise in interest rates during the latter years of the decade, debt service obligations of the developing countries have increased rapidly. Short-term rates in the past decade were more volatile than long-term rates, but all rates were on a rising trend, increasing the interest costs of bank and bond debt. Total debt service payments of the LDCs to all lenders, official and private, during 1982 were estimated to have reached about $130 billion. Of this total, about $60 billion or nearly one-half was for interest and $70 billion for amortization of the outstanding debt. In comparison, during 1971 total debt service payments amounted to $11 billion, of which $3.3 billion or about one-fourth was for interest and $7.7 billion for amortization. In 1982, the debt service to private capital markets amounted to something like $67 billion, with payments to private commercial banks accounting for the largest portion by far ($56 billion). In addition, service payments on export credits amounted to $45 billion. Payments on official credits were, of course, much smaller, being made on concessional terms and being paid on a smaller total magnitude. (See table 4.)

Commercial interest rates are determined in the money and capital markets of the industrialized countries. Short- and medium-term interest rates have, as noted

earlier, become increasingly volatile in recent years, and as a consequence most lending has been done on a floating rate basis. The interest rates paid by developing countries are usually determined in form of a spread over the so-called London Interbrain Offered Rate (LIBOR) in the Eurocurrency market, or prime rate in the United States. LIBO-Rates reached an all-time high

TABLE 4

Total Annual Debt Service of Developing Countries
During 1971-1982, by Source of Lending

Billion U.S. Dollars — Part. Est.

| Source of lending: | 197 | 1975 | 1976 | | 1977 | 197 | 198 | 198 | 1982 |
|---|---|---|---|---|---|---|---|---|---|
| DAC Countries and Capital Markets | 9.2 | 22.0 | 27.1 | 36.3 | 51.7 | 66.5 | 75.8 | 95.9 | 115.2 |
| I. DAC-ODA | 1.4 | 1.8 | 1.9 | 2.0 | 2.3 | 2.6 | 2.8 | 2.9 | 74 |
| 2. Capital Markets' | 2.7 | 9.5 | 2.8 | 17.8 | 28.8 | 38.3 | 43.4 | 57.5 | 67.0 |
| Private Banks | N.A | 8.1 | 10.6 | 14.4 | | 33.1 | 38.1 | 49.6 | 56.0 |
| 3. Total Export Credits | 5.1 | 10.7 20.5 | 12.4 | 16.5 | | 25.6 | 29.6 | 35.5 | 44.8 |
| Multilateral | 0.9 | 7 2.0 | 2.6 | 3.3 | | 3.8 | 4.8 | 5.6 | 6.7 |
| Other | 09 | 2.1 | 2.6 | 3.1 | 40 | 5.3 | 6.4 | 7.8 | 94 |
| Total Debt | 11.0 | 25.8 | 31.9 | | 43,1_ | 75.6 | 86.9 | 199. | I3 .3 |
| of which: Interest | 3.3 | 9.3 17.6 | 10.5 | 12.9 | | 26.0 | 37.2 | 48.5 | 60.1 |
| Amortization | 77 | 16.5 | 21.4 | 29.2 | | 49.6 | 49.7 | 60.8 | 71.2 |
| Annum Nominal Increau: | (IS) | (19) (40) | (24) | (32) | | (28) | (IS) | (26) | 120) |

* Bank Loans (other than export credits) including loans through offshore centers, bonds
and other private lending.
N.A.- Not Available
Sources OECD External Debt of Developing Counnies 1982 Survey

in the third quarter of 1981. LIBOR declined in 1982, but spreads widened. Examination of comparative spreads paid by different borrowers reveals the differences between borrowers in developed and developing countries, and between individual borrowers within those countries. (See table 5 for some representative rates on recent syndicated loans to developing countries.)

Differences in spreads indicate the differences in risks perceived by lenders in lending to a specific country or a specific borrowing entity under existing competitive market conditions. Spreads are, however, only a small portion of the cost of money. Most of the cost results from prevailing interest rates in the creditor countries. Thus, determinants of interest rates in the industrialized countries, such as domestic money market conditions or the general demand for loans

TABLE 5: Representative Rates on
Some Recent Syndicated Loans to Developing Countries

| Sovereign | Amount | Tenor | Spread |
|---|---|---|---|

| Country | Borrower | Date | (S | (Years) | LIBO |
|---|---|---|---|---|---|
| Brazil | ELETROBRAS | 3/82 | 70 | 8 | 2ys |
| | NUCLEBRAS | 4/82 | I50 | 8 | P/ |
| | ELETROSUL | 4/82 | 135 | 8 | 2% |
| | Itaipu Binacional | 2/83 | 12 | 8 | 2/ |
| Mexico | NAFINSA | 5/82 | 400 | 3 | |
| | UMS | 6/82 | 1367 | 7 | I"/ |
| | PEMEX | 6/82 | 60 | 4 | Va |
| | Olivetti. Mex. | 12/82 | 15 | 6 | 1% |
| Venezuela | BIV | 4/82 | 170 | 3 | |
| | INOS | 6/82 | 310 | I | '/r |
| | Republic of V | 8/82 | 200 | 7 | $ |
| | Elects. Caracas | I/83 | 20 | 5 | 134 |
| Panama | Republic of P. | 5/82 | 225 | 8 | I'/ |
| Jamaica | Air Jamaica | 2/83 | 13 | 10 | 11,4 |
| Korea | Republic of K. | 8/82 | IS | 10 | y, |
| | EXIM/Korea | 3/82 | 300 | 8 | |
| | KEB | 5/82 | 300 | 2 | y |
| | | | | 6 | h |
| | Ceil Synch. | 1/83 | 10 | 3 | |
| Philippines | United Coconut | 5/82 | 42 | 10 | 74 |
| | NPC | 9/82 | II | 10 | |
| | FPHC | 2/83 | 33 | 8 | I% |
| Indonesia | Republic of I. | 4/82 | 300 | 10 | % |
| | PT Per wick A. | 8/82 | 28 | 3 | 1~ |
| | | | | 5 | 1y |
| | PT Gadjah T. | 9/82 | 40 | 5 | 1'h |
| Malaysia | Federation of M. | 8/82 | 440 | 8 | '/ |
| | Sabah Gas led. | 8/82 | 25 | 10 | y |
| | Public Sector Co. | 10/82 | 12 | 7 | |
| Ivory Coast | Republic of I.C. | 8/82 | 22 | 8 | I |
| | Republic of I.C. | 12/82 | 123 | 8 | I'h |
| Morocco | BNDE | 2/82 | 53 | 6 | 1'/s |
| | SAMIR | 6/82 | 70 | 5 | I |
| | OCP | 2/83 | 25 | 8 | Is/, |
| Nigeria | NNPC | 4/82 | 80 | 4 | ~ |
| | | | | 4 | Yx |
| | | | | 3'F | I |
| | Nigeria Airways | 1/83 | 10 | 8 | y,, |
| Turkey | TCZ.Bankasi | II /82 | 200 | 3 | p/ |

Source: Ermine Syndication Service, 1982 and February 1983.

and the availability of funds for loans, are of critical importance for the developing countries. But the developing countries cannot reduce. these rates by their own actions. More important, developing countries able to borrow in capital markets

and in foreign currencies have typically found rates in the creditor countries "cheap" compared with the cost and return on capital domestically in their own country. Furthermore, much of the developing country borrowing has been done by governments that are more sensitive to comparative spreads over LIBOR or prime than to interest rates.

It is useful to compare the past decade's growth in Third World debt and the rapidly growing debt service obligations with other national and world economic indicators. One relevant indicator is the growth in world trade over the same period. The external debt of the developing countries, in nominal terms, has been increasing from 1971 to 1981 at an average of almost 20 per cent per year. If the nominal increase in external debt is deflated by the increase in the prices of imports from developed and oil-exporting countries, then the real growth in the external debt of non-oil developing countries averaged about 5 per cent per year. This means that, in real terms, the external debt of these developing countries has roughly kept pace with the domestic growth of their economies. By comparison, from 1971 to 1981, exports of the non-oil developing countries, in real terms, grew at an average of S percent per year.

It may be questioned whether the external debt of developing countries will continue to rise. Will recent experiences cause banks to reduce their foreign exposures? Will other sources of external credit become relatively more important? On past occasions I have stated that I thought the external term debt of developing countries might well rise from about $530 billion at the end of 1981, and $625 billion at the end of 1982, to about $1,500 billion at the end of this decade. This projection implied an annual average increase in external term debt of $100 billion (net of amortization payments). It implies gross borrowings of about twice that amount, namely $200 billion average per year for the decade. Of the projected total of $1,500 billion, I had anticipated that as much as $1,000 billion would come from private commercial banks, which meant that if this analysis and outlook proved correct, private bank exposure would quadruple in the decade of the I980s, while exposure of other sources would about double.

The question arises whether this outlook is still realistic in view of recent events in countries such as Poland, Mexico, Brazil and Argentina. Many bankers talk as though they wish to reduce their lending to developing countries. Yet the financial needs of the developing countries have become greater, if anything, with today's global depression and with pressures to return to higher growth rates in the developing economies. And the demand for capital will continue to increase.

I still believe that the external term debt of the developing countries will mount to about $1,500 billion by the end of this decade. It may well be higher. But the question remains, whether the private banks will contribute as much as I had earlier anticipated. Much depends on whether governments are prepared to become relatively more important in providing total development finance. I foresee the industrialized countries increasing their lending, particularly through the multilateral agencies. I do not, however, see at this time a substantial shift in proportions of total flows, provided total flows from all sources continue to rise. At the moment, it is difficult to give a clear answer to the crucial question of how much the banks will lend in the future. My intuition is that after we have crossed the current rough patch, the private banks will be back in the business of lending to developing countries, because international lending to developing countries can be done at acceptable risk and is profitable to the banks.

## POLITICAL ECONOMY OF THE EXTERNAL DEBT SITUATION

In the early 1970s, I became convinced that the developing countries had created the ability to absorb effectively much larger inflows of capital than could be expected to be available from official, concessional sources. I had long believed that much of development finance should be on a grant-like basis, similar to the Marshall

Plan or the International Development Association (the IDA). However, years of involvement with the replenishment of IDA resources had made me pessimistic that sufficient grant funds would be made available, because they involved budgetary expenditures.

The availability of concessional funds in form of loans from the World Bank and the regional development banks, e.g., the InterAmerican Development Bank and the Asian Development Bank, seemed more promising. Private funds rather than budgets were the primary sources of funding of their lending operations. The tapping of capital markets was made possible by the provision of subscribed capital by member countries, and free funds in the form of paid-in capital and reserves. Reserves in these institutions grew rather rapidly because member countries did not vote dividends on net earnings, and profits of these development banks were exempt from taxation. This subscribed capital became, in effect, contingent liabilities for the budget, in case callable capital was needed to defend the ability of these institutions to service their own obligations. In the 1960s, U.S. balance-of-payments difficulties and tight budgetary conditions were clearly constraints on the expansion of these entities, particularly if expansion meant amending Articles of Agreements as, for example, permitting lending at levels more than total capital and reserves.

The possibility of increased commercial bank lending to developing countries was attractive. Banks could lend in much larger magnitudes, quickly, and at interest ratess determined in the financial markets of creditor countries. Such borrowed funds could be used freely anywhere in the world. These funds were more costly and, on average, for shorter maturities than official, concessional funds. Commercial funds were not a preferred form of development finance. but preferred sources alone were simply inadequate.

With the events 01 1973-74 came an explosion in commercial bank lending to developing countries, in total magnitudes, purposes, ‘ maturities, countries, instruments, etc. Many expressed concern, giving warning to banks and borrowers of the dire consequences of such expanded activities. Excessive debt burdens resulting in widespread simultaneous defaults were predicted for borrowing countries.

Bankruptcies were predicted for lenders. The 1974-75 expansion was k seen by many as temporary: lenders and borrowers could not, or ‘ would not, maintain this expansion. Repeated predictions of reduced commercial bank lending were made. However. I believed then that private bank lending would continue to expand greatly and would become a major source of external finance for selected developing G countries. Moreover, 1 argued that such lending would not result in serious losses to the banks and, on balance, would prove both profitable and able to meet conservative standards of acceptable risk to a commercial bank lender.

The essentials of my reasoning were as follows: A,net inflow of , financial resources into the developing countries was imperative, except for relatively short periods of time. Official sources of financing would continue to be inadequate. Borrowing countries would 7 have virtually no choice but to meet the lending criteria of private mmercial lenders. Borrowers would also find that the size of external debt and debt servicing obligations were not of decisive importance in their ability to find lenders. More important would be judgments on the economic and financial management of the country and the priority given by governments to meeting their external obligations fully and promptly. The defense of country creditworthiness was possible, though not easy. Highly professional country risk analysis and country risk management processes could be invented and used by lending banks. Bank regulators could see for themselves that the banks knew what they were doing. Inevitable adversities could be guarded against by avoidance of portfolio concentration and strict credit analysis and implementation. Banks could assume full responsibility for their own lending decisions. As long as private lenders were careful to match funding costs to earnings through variable interest rates and other devices, they could operate in the strange new world of persistent inflation.

I also believed that private commercial lenders would find LDC borrowers to be responsible and eager to honor their obligations. Debt servicing would be found difficult from time to time but, in the end, would be performed satisfactorily because developing countries would not default or declare moratoria, though some might suggest these actions. Developing countries would be willing to pay LIBOR and profitable margins over LIBOR. Banks would avoid unprofitable margins. Comparative margins over LIBOR would be closely scrutinized by borrowers, since governments would not want to be seen to be paying more than comparable other governments. Thus experience would eventually at least partly allay doubts within lending institutions.

Debt rescheduling could be used, if borrower and lender thought it desirable, but care would have to be exercised to avoid rescheduling which could not help restore the creditworthiness of countries. During the second half of the 1970s, some rescheduling of private commercial bank debt were undertaken. Comprehensive cases, such as Zaire and Peru, were pursued with the objective to restore the countries' creditworthiness by insisting on economic reforms as a precondition for the extension of new loans. At that time began the cooperation of the IMF with the private bank debt rescheduling, with private banks looking to the IMF to certify that the countries' economic reforms were appropriate and to ensure that new bank loans were phased in proper sequence with use of IMF funds.

Under these conditaion will pravite lenders conculde that developing countries. With few exception, are not able to meet the criteria of country creditworthiness? Country creaditworthiness dose not imply the absence of difficuolties or serious risk . such risk are narmouly reflected in the cost of money and maturities to borrowers. When ythe perceived risk are too many and too serious. The country loss its creditworhiness. Country creditworthiness is not a matter of hindsight; it is a judgment about the future. Unfavorable elements are nearly always present, as well as favorable and promising. Because of these uncertainties, portfolio diversification is a vital part of a private lender's country risk management. Closely related are the limitation of exposure in any one country and the subdivision of these country exposure limits by major categories of maturities, borrowers and purpose of loans. Another vital part of country risk management is a method of dealing with adverse conditions when they arise.

Despite the difficulties and uncertainties, I believe that international lending to developing countries will continue to expand substantially. This judgment is not due to a rose-colored view of the world nor to a naive view of bank management. It is based on an awareness of the underlying conditions and needs in countries which have two-thirds of the inhabitants of our world, combined with experience in international lending by the major sources of finance. Developing countries have to borrow well over $100 billion per year to meet debt servicing obligations. Some relief can come from lowered interest rates. Some relief is provided by reschedulings. However, the bulk of the obligations remains. In addition, developing countries need either sustained net inflows of capital from somewhere or drastic improvements in their terms of trade. Their adjustments to depressed world economic conditions are painful at best, explosive at worst, but inevitable. Capital imports reduce some of the pain and frequently ward off explosions. In the absence of adequate alternatives, borrowers will originally seek to meet the lending standards of available sources of funds. Programs like export credits are likely to expand; the multilateral development banks will also expand; but private bank lending is likely to continue to be critically needed.

Will the private commercial banks respond positively to these demands for funds? It may be that many banks will not choose to lend more to developing countries; some may choose to reduce their exposure. These moods surely exist in many lending banks. However, 1 do not expect these moods to dominate after this year or so, because the developing countries will have no satisfactory alternative except to meet the criteria of available lenders, official and private. 1 expect the public utterances of some borrowing countries which might sound

very different-even threatening default-not to prevail when the lack of alternatives becomes evident. The avenues to be explored will be those leading to new external funds to developing recent countries from private sources. Some lessons from h I am private commercial lenders can take come with brevity . There is nothing experiences. I would lit fiction which may c less n N hire aware inng simple thei mwhat has happened in recent y the implications of these even become unacceptable borrowers within tl) Strong borrowers can warning signals, but short periods many of time. There are many early eC1ng analysis and such cases ring the dangers and hamp present, obscu correct judgments can be made. increasing weakness and erosion of con judgments of risks. Nonetheless, creditworthiness can be swift'

tz) The transfo'o a c ritical o loss of capital t, drastic ence loss of reserves Events like publicized over-valuat ion community of currencies, es intersuspension of publication chang , as wrong or as a loss of control data, drastic unexpected p come overnment, can bring financial crises. Country or early warning systems cannot be base on ontrol publicized the reins statistics of g or other information sources which g°

Silent during moon such storing critical periods. Banks must be able to make judgments from their own internal current sources. to play a much more public a and men active role crisis

13) The IMF is prepared to manage a balance-01_p Y than before in helping international lending

and achieving a solution. Transform (4) Most important, and what may practice that borrowing countries in , is the balancesolidiaicments difficulties do not look to defaults future years or moratoria to find help in coping with their balance deficits. - They have on hand a tried and efficient mechanism of debt renegotiation which. unlike default, can pave the way for renewed borrowing, Particularly if their policies are reviewed and endorsed by a. respected outside authority like the IMF. For the lender prevention °f being government ng when the borrower is an s ticu arty s that the prower losses meet or a simplified. P greatly government-ownedentit or is zcncal difficulties, such as guaranteed. There are still many other of default d either put agreement on acceptable terms with banks and then with borrowers But the "sword of Dam away or hangs by a chain, not a thread.

(5) The protection of the bank is no longer found in declaring an event of default and its well-known consequences. This is not excluded as an ultimate act or sanction, but, in practice, protection is sought elsewhere-in better country monitoring; more diversified portfolios; terms and conditions of rescheduled debt; more cooperation with other banks in exchanging information and judging risks; support from the IMF and other multilateral organizations; professionalism of staff and others involved in making country risk judgments and lending decisions; country risk management systems; etc.

(6) Another lesson is the need for more knowledge of countries. To me, this is the basic approach to handling country risk. 1 welcome the new center for banking information and analysis being established in Washington. It can make a major contribution to the viability and the role of international banking in theDeveloping countries.

**RECOMMENDATIONS REGARDING PRIVATE COMMERCIAL BANK LENDING TO DEVELOPING COUNTRIES**

Having drawn certain lessons from recent events! I believe that the international banking system should be strengthened to restore confidence in its ability to cope with ever-present risks, and thus to avoid further politicization of bank lending to developing countries. The vulnerabilities need not remain as they are.

The following measures could be taken to strengthen the inter national banking system in the period ahead:

(I) Individual banks should reserve full responsibility for the management of their assets.

(2) Bankers should improve their country evaluation and risk management systems.

(3) Borrowers should be alerted to the need to provide full and current information, for the assessment of country conditions
And outlook.

(4) Bankers should proceed with the establishment in Washington of the proposed international clearinghouse for information and views on banking.

(5) Regulatory authorities and banks should encourage the improvement of available country exposure information and its widest possible dissemination.

(6) Existing procedures for evaluating portfolio diversification should be reviewed, as should the adequacy of reserves and the treatment of non-performing and doubtful loans.

(7) The financial capability of the IMF should be strengthened through increases in quotas and greatly increased Fund borrowings from official and private sources, to help members fulfill their obligations under the Fund's Articles of Agreement.

(8) Existing mechanisms and procedures for renegotiations and reschedulings of external debt should be improved.

(9) Commitments on inter-bank credit lines among major international private lenders should be strengthened to ensure continuation of such lines during difficult periods, and so to reduce the need for official support.

(10) The equivalent of a BIS for central banks should be established for commercial banks, especially a standing mechanism for informal and private exchange of views among senior bank managers.

(11) Borrowing nations should reconfirm their determination to avoid defaults and moratoria.

(12) The scope of joint, cooperative or simultaneous actions by public and private lenders in providing external finance to developing countries should be broadened.

(13) The roles of multilateral development banks in lending and in assessing country conditions and policies from a developmental viewpoint should be expanded. This would require close collaboration with each other and the IMF.

(14) Increases being proposed for the IMF, multilateral development banks, and the International Development Association (IDA) should proceed quickly, to help these institutions fulfill their internationally agreed purposes.

If these measures are acted upon, we can proceed with expanded international lending to developing countries, making full use of all available financial mechanisms. Even with the efficient use of all mechanisms, the international financial flows are likely to be less than needed for the mammoth job of world development.

The world economy needs new approaches based on novel thinking Banks must change their ways of doing international business, especially assessing risk and being prepared for reschedulings and new lending as part of their longer-run relations with countries. Lenders need answers to difficult questions such as, What criteria should guide new lending to a country being rescheduled? How to relate to IMF action? How to judge appropriate portfolio diversification? How to prevent excessive reschedulings by making them too easy for debtors? How to avoid excessive management time spent on re-scheduling exercises? How to anticipate reschedulings in original contracts? How to reduce time between interruption of debt servicing and renegotiated loan contracts? And many other questions come to mind, because the use of

reschedulings in the context of practical elimination of defaults is novel.

I believe that international lending by private banks to developing countries will continue to rise in the years ahead. The year 1983 may show less of an increase because of the shock effects of 1982. However, even in 1983, lending to certain parts of the world, particularly Southeast Asia and the Far East, is offsetting the slowdown to various Latin American countries. I also believe that those who are now rather critical about lending to developing countries will show themselves eager for it to resume in needed magnitudes. Neither the budgets of the world nor balance-of-payments behavior are likely to encourage a great increase in official development assistance of various forms. And we will not see much more in the way of equity financing or long-term fixed interest rate borrowing. Thus, I do not expect a reduction of the reliance of developing countries on private, non-guaranteed external sources of financing. Banks will continue to have full responsibility for their lending decisions, and, as in the past, international lending will be demand driven. On balance, the demand will be greater than ever.

Thus, I expect the continuation of conditions which will induce higher volumes of private bank lending. And when the smoke is cleared, it will be found that the private banks do not need to be bailed out by either governments or international agencies.

The crises of 1982 are now past, though the defensive measures are still being put into place. Of course, lasting changes may result from the crisis. There are two broad categories of possible developments. One is the increased involvement of official institutions in the lending decisions of the banks. The other is strengthening of the private banks' ability to judge country risks and manage such risks at comfort levels acceptable to management, shareholders, and bank supervisors. In either case, we are in for a period of major institutional innovations by private and official lenders.

# CHAPTER 8
## Implications of the External Debt for International Finance
**Carlos Massed**

Increases in the foreign debt have been an unavoidable development in the world economy in the last few years. Such increases are not the consequence of lack of responsibility in the domestic policies of borrowing countries, even though some cases of irresponsible policies can be found. They are not the consequence of banks' carelessness in assessing the risks involved in foreign lending, even though some examples of that can be found also. They are rather a consequence of the fact that, in the last ten years or so, surpluses and deficits in different parts of the world tended to accumulate at too fast a rate. There were countries where surpluses grew up very fast, while in others, deficits expanded very fast. There was no opportunity, no possibility at all to handle these problems through, for example, direct investment or equity investment, because there was no time for the world to adjust to such rapid changes. The only possible way to handle this kind of a problem was the way in which it was in fact handled-lending and borrowing. Thus, the rapidly growing debt has been a natural consequence of other world economic events of the last decade or so.

The debt level existing at this time would be sustainable under normal conditions of the world economy, if one defines as normal the average conditions prevailing in the world economy for the last 15 to 20 years. In the case of Latin America, for example, calculations made for 18 non-oil exporting countries, for which the deficit in current account in 1981 was $25 billion,

show that the deficit would have been only $1 billion if terms of trade had been those of the late '60s or early 70s and if interest rates had been those of 1979. Under those two conditions, the deficit would have shrunk from $25 billion to $I billion. Nobody can argue that $1 billion is an unsustainable deficit for a continent like Latin America. Thus, 1 would say that under normal conditions of the world economy, foreign debt is sustainable. Of course one can find examples of a few countries in the world where this does not apply.

1 will not go into the short-term approaches to solution of the debt problem; each country has its own way of going about it.

Renegotiations are going on, and although their results could be better-with longer maturities and lower costs for renegotiated loansthat is a matter for discussion between debtors and creditors.

I would like to go into some of the longer-term consequences of the present situation, in a scenario of slower growth and higher interest rates than experienced, on the average, in the last decade. At least the following areas will be affected:

(I) the mechanisms for transmission of international disequilibria; (2) the provision of liquidity;

(3) Stability of exchange rates;

(4) Aid and the volume of aid; and

(5) The sharing between creditors and debtors of the costs of difficulties in the financial system.

I. Firstly, with present levels of debt, interest rates have become as important as terms of trade in the transmission of disequilibria internationally. In fact, in the case of Latin America, one percentage point of change in external interest rates, up or down, implies a $2.4 billion change in the current account deficit of the balance of payments, and that is equivalent to a 3 to 4 per cent change in the total value of exports of the region. In the particular case of Chile, a change of one percentage point in interest rates, held for a year, is equivalent in its effect on the balance of payments to a 12 per cent change in the price of the most important Chilean export, copper. Changes in interest rates have thus become very important in the transmission of international disequilibria. Furthermore, interest rates and terms of trade move in such a way as to affect the current account of the balance of payments in the same director when interest rates go up, usually there is a slowdown of world development and a reduction of inventories, which implies deterioration in terms of trade, so that the two effects compound rather than counterbalance each other.

Another new mechanism for the transmission of international disequilibria is the instability in the supply of lending. As rates of growth in the world deteriorate, terms of trade for LDCs deteriorate also, as does the quality of the portfolio of lending banks. This makes banks more reluctant to lend precisely when they should be contributing to finance the disequilibrium problem through increased lending. So interest rates, terms of trade and the supply of lending interact perversely in the international transmission of disequilibria. Interest rates and the supply of lending are directly under the control of U.S. monetary authorities, so that LDCs have become "Federal Reserve watchers." In the same sense that firms in Wall Street watch very closely what the Federal Reserve is doing in order to predict the behavior of the prices of stocks and bonds, developing countries have become "Federal Reserve watchers" in order to try to predict and anticipate the effect of Federal Reserve policies on their own balance of payments.

2. A second aspect of the present scenario is that the provision of liquidity has been made erratic, since the largest source of liquidity for the world has been the expansion of the banking system. As this expansion is suffering with the world economy, the provision of liquidity in general also suffers perversely with the world economy. When the latter slows its growth, the provision of liquidity is made more stringent, with destabilizing consequences. I would make one additional point. The U.S. has recently become a net importer of capital in the form of dollars, so that the supply of dollars abroad, and perhaps of other currencies, tends to shrink.

In fact, to obtain dollars from their monetary authorities, non-U.S. residents have to surrender domestic currency, affecting their own domestic money supply. This situation implies a reduction of world liquidity. Thus, the developments of the past ten years or so have made the provision of world liquidity both more restricted and relatively unstable.

3. Exchange rates are related to interest rates in their movements. As interest rates have become more volatile, so have exchange rates, introducing additional difficulties in trade and external payments. This volatility persists despite intervention efforts, which so far have proved incapable of solving the problem.

4. The fact that bank financing was easily available-not freely, but amply available-has also been an element in the decision of governments to restrict aid or at least to restrict increases in aid. Once aid is limited, its rebuilding is extremely difficult, requiring new political decisions, congressional support, etc. This kind of effort is difficult and time-consuming, and so aid has tended to suffer.

5. Finally, the fact that most of the increases in countries' liability have been due to borrowing from banks implies that previous mechanisms for sharing difficulties between creditors and debtors have disappeared. As a matter of fact, debt problems are not new; the world had very severe debt problems in the Great Depression of the 1930s. But at that time, most borrowing by developing countries was done by selling bonds in the markets. When the depression struck and debtor countries faced difficulties in servicing their debts, the price of bonds went down, and borrowers could buy back their debts at a fraction of the original cost. In that sense the cost of the recession was being shared between borrowers and lenders. At present there is no market for bank portfolios which could play a similar role, so there is no opportunity for the kind of adjustment that was done during the Great Depression.

These elements are, in my view, the most outstanding characteristics of the present world financial situation. Their handling would require a change in the composition of liabilities of debtor countries, to reduce their external vulnerability, or a decrease in total liability. To think in terms of a decrease in total liabilities appears unrealistic. The cost for debtors, in terms of unemployment and human suffering, would be politically unbearable, and it cannot be expected that creditors in general would be willing to forgo their credit.

The way out, then, is a recomposition of these liabilities into more manageable forms. There are several possibilities:

First, equity investment could take part of the role that borrowing has played in the recent past. Perhaps it will never be as important as borrowing has been, but it could play a larger role, perhaps through the tapping of new layers of investors. Here there is a challenge to the imagination, to think of new ways and new instruments through which equity investment could play a substantially larger role in debtors' liabilities than it has played up to now.

Another possibility is that of borrowing from international organizations with fixed, rather than floating interest rates. In this connection, high priority should be given to the strengthening and expansion of regional banks, which have seen their relative importance diminished rather than enhanced, and some of which are facing serious liquidity problems.

Official government-to-government lending is another area of special importance for the transformation of liabilities, both in the form of direct lending and of guarantees. This is an instrument or form of financing which has particular importance for the least developed countries. One possibility in this area is for governments to continue going the way some creditor countries have already gone, in writing off the debt of some of the least developed countries.

In brief, from the point of view of the composition of liabilities, 1 would stress the need to increase the role of equity investments, new layers of investors, international organizations, and official lending and guaranteeing.

Finally, 1 would like to address the question of how to dampen the effects of instability. Instability will be with us, perhaps forever. We cannot avoid it, but we can find ways to dampen it. In regard to instability of interest rates, there are a number of possible approaches. One is to attain better tuning of policies among the larger economies of the world, so that they do not promote instability in interest or exchange rates, but rather help to stabilize them. Also in the area of interest rates, there is a proposal, recently presented by the Mexican delegation, to establish a facility within the IMF for compensatory borrowing when interest rates go too far above their norm. This proposal should be explored further.

The instability of liquidity, which arises from the erratic growth of bank lending and from the fact that the U.S has become a capital importer, can be properly handled by an instrument already in our possession: SDRs. Clearly the IMF should take an important role in dampening out fluctuations and managing global liquidity, so as to keep it closer to needs, through allocation of SDRs.

Regarding instability of the supply of international credit, there are roles for many different institutions, including the IMF, World Bank, regional banks, etc., and for bank controllers and private banks in the creditor countries. Possible measures include evaluating portfolios on a longer-run basis than is usually done, and establishing better communications between debtor bank controllers and creditor bank controllers regarding the criteria used for control, so that both understand what is involved in borrowing and lending.

A final suggestion for dampening the effects of instability is SouthSouth cooperation, that is, cooperation among developing countries. Latin America is already working in that direction, as are other regions. 1 can point to several initiatives. In the case of Latin America, for example, there is a system of automatic credit to finance trade between countries, which is being expanded and strengthened. Two or three of these systems in the continent are now being interlinked, and ideas have been formulated for a Third World Bank or for a regional bank acting in the commercial and capital market areas which show some promise for positive results.

# CHAPTER 9
# The Outlook for Development Finance after the Debt Crisis
**John Williamson**

The world seems to be emerging from the debt crisis. (A "crisis" is defined by the Concise Oxford Dictionary as a "turning point ... - moment of danger or suspense": the fact that the debt crisis did not culminate in a collapse does not mean that it was not a crisis.) The danger is not yet over, but the prospects for all three of the conditions needed to assure emergence from the crisis now look a good deal brighter than early in the year. (1) The major debtors have shown commendable determination in tackling the need for vigorous adjustment. (2) The commercial banks have largely lived up to the commitments they made last winter to maintain a (reduced) flow of (involuntary) lending. (3) Finally, recovery is at last clearly under way, at least in the United States. So, while involuntary bank lending is likely to remain necessary for some time yet, and while the cost in terms of forgone growth in the developing countries has been crippling, it is time to turn attention to what will happen after the debt crisis.

The immediate prospect is for much reduced flows of finance from commercial

banks to developing countries with no substitute source of funds readily available. The first pan of this paper attempts to establish how serious the shortfall of funds is likely to be on the basis of present trends. The second part discusses the prospects for reestablishing a major role for the commercial banks. The third part. Of the paper considers an alternative that has attracted considerable recent discussion, direct investment. The fourth section deals with other "traditional" sources of funds, namely the official sector, suppliers' credits, and bonds. The final section explores possible non
traditional sources.

## 1. THE DEMAND FOR AND SUPPLY OF DEVELOPMENT FINANCE

A recent study by a colleague of mine at the Institute for International Economics, William Cline (1983), develops an estimate of the current account deficit likely to confront the non-oil developing

TABLE I

Prospects for the Current Account Balance of Non-Oil Developing Countries, 1982-86
(5 billion)

| Projection | 1982 | 1983 | 1984 | 1985 | 1986 |
|---|---|---|---|---|---|
| /actual) | | -76 | -64 | -53 | -53 |
| William Cline | -87 | | | | |
| Morgan Guaranty | -87 | -51 | n.a. | -35 | n.a. |
| IMF | -87 | -68 | n.a. | n.a. | -93 |

Source: Cline (1983. Table 20).
n.a. = not available

Countries up to 1986. Cline's own projection is based on 16 countries and then blown up to generate an estimate for all the non-oil developing countries by assuming that the deficit of the 16 countries by assuming that the deficit of the 16 countries remains the same proportion of the total in the future as it was in 1982. Morgan Guaranty has recently undertaken a similar exercise, based on 8 countries. The results of those two exercises and of the projection in the latest issue of the IMPS World Economic Outlook are presented in table I.

It can be seen that there is agreement that the deficit is declining very significantly from the peak of over $100 billion that it reached in 1981. There is, however, quite a range of views as to how far and fast the deficit will fall and as to whether it will start expanding again before 1986. All the estimates assume continued vigorous pursuit of adjustment by the debtor countries and a sustained, though restrained recovery by the North.

Adding on likely current account deficits by the OPEC high absorbing countries, Cline suggests that a central figure for probable demand for finance by developing countries would be on the order of $75 to 80 billion per annum for 1984 to 1986. Note, however, that Morgan Guaranty's figures imply a significantly lower estimate of borrowing needs, while the IMF has a substantially higher figure by 1986. Cline's estimates allow for some resumption of developing country growth, gradually accelerating from 2%t per cent in 1983 to 44 per cent in 1986. This is, however, still lower than the average of 5 per cent per annum realized between 1973 and 1980, which in turn was lower than in the preceding decade; it looks satisfactory only in comparison with the figure of under I per cent to which growth fell in 1982. If more finance were available than the "needs" assumed in table 1, the growth of developing countries could

be faster. For example, Morgan Guaranty Bank (1983) estimated that the $25 billion cutback in bank lending to LDCs in 1981 imposed a loss of about I y7 per cent of LDC GNP. This estimate seems, if anything, to be on the modest side.

The reason that there is a problem in finding funds to satisfy demands of the size shown in table 1 is the sharp fall in commercial bank lending to developing countries in 1982. The IMF estimates that net bank lending to non-oil developing countries fell from over $50 billion in 1981 to only $21 billion in 1982. This $30 billion decline in new lending was, of course, superimposed on the current account difficulties of the non-oil LDCs resulting from the worst terms of trade for primary commodities since World War 11, a fall in exports due to the world recession, and very high real interest rates on outstanding debt. Despite those difficulties, LDC deficits have fallen substantially (table I), matching at least a third (on Cline's estimate) and perhaps more than matching (on Morgan Guaranty's estimates) the fall in available bank finance. The rest of the decline in bank lending has been matched by increased use of reserves, increased reserve borrowing, and, to a minor extent, by increased World Bank lending (the "special action program" of some $2 billion).

What are the prospects that the LDCs will be able to continue raising enough cash to finance the deficits shown in table I? Cline offers two estimates of the sums likely to be forthcoming (last two columns of table 2). In his optimistic Case A, commercial banks continue lending some $23 billion per annum, equivalent to an annual increase in exposure of about 7 per cent per annum, and the IMF quota increase provides sufficient funds to allow the Fund to lend a net $8 billion per annum. That provides just enough cash to finance the deficits projected. In Cline's pessimistic Case B, the banks cut back to a minimal $10 billion per annum of net new lending and the O.S. Congress rejects the IMP quota increase, forcing the Fund to restrict its net lending to $2 billion per annum. This makes it impossible to finance the deficits projected in table I, which would

TABLE 2

Sources of Development Finance, various years (percentage)

| 1975-67 averages | | 1978• | 1983-86 average Case A | Case B |
|---|---|---|---|---|
| Aid | 42 | 16 | 31 | 43 |
| Direct Investment | 17 | 13 | 15 | 19 |
| Banks | 6 | 38 | | |
| Bonds | _ | 7 | 32 | 19 |
| Suppliers' credits | 6 | 6 | 4 | 5 |
| MDBsandIMP | 36 | 19 | 18 | IS |
| Short-term | | | | |
| Total | 100 | 100 | 100 | 100 |
| Memorandum Item | | | | |
| Total ($ billion) | 3.7 | 30 | 78 | 54 |

Sources: World Bank and Cline (1983, Table 21)

Notes: a. 12 major debtors.

b. All non-oil developing countries and selected (non-capital surplus) OPEC countries.

dictate further reduction in LDC growth below the 2/ per cent rising gradually to 4/ per cent assumed in table 1.

Two conclusions suggested by these figures provide the basis for the remainder of this paper:
(I) that it is a matter of the first importance to the developing countries that flows of finance reach at least the level shown in Cline's Case A; and
(2) that more finance than seems likely to be available could be productively employed in accelerating the rate of growth.
The first two columns of table 2 attempt to provide some historical perspective on the various sources of funds included in Cline's projections. Unfortunately they relate only to 12 major debtor countries', so that they are not directly comparable. They nonetheless Argentina, Brazil, Chile, Colombia, Egypt, India, Korea, Mexico, Nigeria, Peru, the Philippines, Thailand. suffice to illustrate certain stylized facts: the decline in the relative importance of aid in the 19705, with some revival in the 19805 reflecting cutbacks elsewhere; the roughly constant shares of direct investment and suppliers' credits; the decline in the relative role of the multilateral development banks; and the explosion in the share of private bank lending in the 1970s, followed by retrenchment in the 1980s.

## 2. THE ROLE OF THE COMMERCIAL BANKS

The first question that arises is whether the future role of the commercial banks is more likely to be approximated by a reestablishment of their preeminent 1970s role; by the severe cutbacks of Cline's Case B; or by the restricted retrenchment of Cline's Case A.
Resumption by the banks of the lending role they played in the 19705 seems to me neither likely nor particularly desirable. Even had there been no debt crisis, I do not believe it likely that the corn- j Mercian banks would have continued to expand their lending to developing countries at the frenzied pace of the 1970s (some 32.5 per cent per annum from 1972-81; Bolin and Del Canto, 1983, p. 1106). In a discussion on this topic in 1981 (in French-Davis, 1983, pp. 140-45), 1 argued that the rapid pace of expansion of commercial bank lending to developing countries in the 1970s was a reflection of a once-and-for-all portfolio shift. When banks first became convinced that the more advanced developing countries were creditworthy, they set about seeking to build up a portfolio of loans to those countries. This led to very rapid rates of expansion of lending; and, as long as the banks had exposure less than an equilibrium share of their portfolio, lending expanded in response to any increase in demand. U.S. banks were the first to enter this market in a big way but by about 1977 appeared to have reached a natural limit to the share of their portfolios. European. Japanese, and Arab banks followed the American lead successively, but by 1981 banks in general were approaching the percentage of their portfolios in loans to LDCs at which U.S. banks had chosen to rein back further expansion. Hence I concluded that commercial bank lending to developing countries was likely to slow down, even without any crisis.
That still seems to me to be a correct appraisal of the basic forces at work. Of course, desired portfolio shares are not rigidly limited; they may rise when expected returns to that type of [ending increase. or fall as perceptions of risk increase. But neither are they completely fluid, which suggested even in 1981 that a slowdown in new bank lending should be expected. The big change since 1981 has been the upward revision in risk perceptions-not just by bankers, but also by bank shareholders, bank regulators, and those who oversee the regulators (e.g., Congressmen). In view of this, it seems to me inconceivable that we shall witness a reestablishment of the dominant role that commercial bank credit flows occupied in borrowing by the middle-income countries in the 1970s.
Neither is that, in my view, to be regretted. Bank loans come in limited maturities (typically 6 to 8 years) and with floating interest rates. This means that the burden of debt service is rather high, and variable. In particular, it varies with events

outside the control of the borrowing country, namely interest rates in the developed countries and exchange rates among the developed countries. It used to be fashionable to deny that the high debt service burden involved in relatively short-term borrowing was of much consequence, since the loans could always be rolled over. A contemporary version of this complacent attitude would presumably be that loans can always be rescheduled. There are, however, costs associated with having to request a rescheduling: in particular, it becomes virtually impossible to raise new money on a voluntary basis. Hence I remain convinced (see Williamson, 1982, for my pre-debt-crisis statement of this view) that a cut in debt service costs as a result of a major stretch-out in the effective maturity of debt would make the borrowing countries very much less vulnerable to inevitable swings in confidence. As for the variability in debt service costs as a result of events exogenous to the borrowing countries, no one foresaw just how crippling the costs might prove to be. While a major reexpansion of bank lending seems neither probable nor desirable, a major cutback (as in Cline's Case B) could happen all too easily and would have disastrous consequences in the absence of alternative sources of finance. It could happen all too easily because, when loans come to be viewed as risky (as are almost all loans to LDCs at the moment), it is to the advantage of any individual "small" bank to reduce its exposure. (A "small" bank is one whose own action in reducing exposure will not have a perceptible effect in jeopardizing the ability of the borrower to continue servicing its loans.) The more other banks are believed to be planning they may raise when expected returns to that type of lending increase,

or fall as perceptions of risk increase. But neither are they completely fluid, which suggested even in 1981 that a slowdown in new bank lending should be expected. The big change since 1981 has been the upward revision in risk perceptions-not just by bankers, but also by bank shareholders, bank regulators, and those who oversee the regulators (e.g., Congressmen). In view of this, it seems to me inconceivable that we shall witness a reestablishment of the dominant role that commercial bank credit flows occupied in borrowing by the middle-income countries in the 1970s.

Neither is that, in my view, to be regretted. Bank loans come in limited maturities (typically 6 to 8 years) and with floating interest rates. This means that the burden of debt service is rather high, and variable. In particular, it varies with events outside the control of the borrowing country, namely interest rates in the developed countries and exchange rates among the developed countries. It used to be fashionable to deny that the high debt service burden involved in relatively short-term borrowing was of much consequence, since the loans could always be rolled over. A contemporary version of this complacent attitude would presumably be that loans can always be rescheduled. There are, however, costs associated with having to request a rescheduling: in particular, it becomes virtually impossible to raise new money on a voluntary basis. Hence i remain convinced (see Williamson, 1982, for my pre-debt-crisis statement of this view) that a cut in debt service costs as a result of a major stretch-out in the effective maturity of debt would make the borrowing countries very much less vulnerable to inevitable swings in confidence. As for the variability in debt service costs as a result of events exogenous to the borrowing countries, no one foresaw just how crippling the costs might prove to be.

While a major reexpansion of bank lending seems neither probable nor desirable, a major cutback (as in Cline's Case 8) could happen all too easily and would have disastrous consequences in the absence of alternative sources of finance. It could happen all too easily because, when loans come to be viewed as risky (as are almost all loans to LDCs at the moment), it is to the advantage of any individual "small" bank to reduce its exposure. (A "small" bank is one whose own action in reducing exposure will not have a perceptible effect in jeopardizing the ability of the borrower to continue servicing its loans.) The more other banks are believed to be planning  a cutback, the greater the incentive to any small bank to

act quickly. Hence the historically frequent occurrence of banking crises. That this catastrophe has been averted so far in the debt crisis is a tribute to the leadership exercised by a group of leading commercial banks and especially by the Managing Director of the IMF. The many small banks whose collective (but not individual) support is essential to the viability of the rescue packages negotiated with the major debtors have been pressured into maintaining and even increasing their exposure. Without any precedent, the IMF declared to the banks that it would be unwilling to approve programs for the largest debtors unless all the banks promised to roll over maturing debt and increase their exposure by 7 per cent in 1983. It thus in principle eliminated the "free rider" problem whereby small banks believe themselves able to pull funds out without influencing the probability of debt servicing being broken off. Any small banks which felt tempted to challenge the credibility of the Fund's threat appear to have been kept in tine by implicit threats of denial of services by the larger commercial banks. In effect, therefore, all the banks have found themselves in what William Cline (1983, Section IV) calls the "lender's trap," a situation where it seems worthwhile to put in a relatively modest sum of new money in order to shore up the quality of the much larger sum at risk in outstanding loans. Such involuntary lending motivated by the lender's trap seems i likely to remain necessary at least for the next year or two. It will therefore also be necessary to maintain the pressures on small banks to continue playing their role. It is by no means certain to prove as easy to keep them in line once the immediate crisis atmosphere is lacking. Yet any refusal by small banks to participate could still generate imitation and lead to a major shortfall in LDC finance, as in Cline's Case B. Since there is almost certainly no alternative source of finance that could replace the banks in the short run, the consequence would be further austerity in the developing countries.

The intermediate case, Cline's Case A, seems to me both the most probable outcome and a reasonably satisfactory one. This case assumes that the banks continue lending on much the same scale as this year, roughly in line with the growth in their portfolios. For the next year or two this lending will be reluctant (or involuntary), reflecting the lender's trap and the pressures to keep the small banks in line. But, provided the North maintains a growth rate of at least 3 per cent per annum, Clines projections (1983, Section 111) show a continuing improvement in the traditonal debt indicators (the dt service ratio, etc.) for most of the major LDC debtors. His to analysis implies that the situation should have improved sufficient by 1985-86 for most countries once again to qualify as creditwortl with the commercial banks. One would not expect to see the bann seeking to reduce their proportionate commitments the mo' dynamic sector of the world economy under that circumstance . Bt neither, in view of the shack produced by the debt crisis, does it seer likely that they would seek to increase greatly the proportion of that portfolio on loan to LDC5. Voluntary growth of bank lending in line with the growth of total assets thus seems a reasonable projection. Moreover, table 2 implies that such an outcome would be adequat< to sustain a (just) tolerable minimum growth rate for the developing countries. But the level of resource transfer and the LDC rate of were in the 1970s.bMorerfinance would translate into tfa terhgo th, as it did in the 1970x. Hence the importance of asking whether other sources of finance might be increased to complement the prospective flow of bank lending without leaving the developing countries as vulnerable to changes in the world economy as they were in the early 1980s.

## 3. DIRECT INVESTMENT

The cutback in bank lending to developing countries has stimulated renewed suggestions that LDCs should seek to attract a larger volume of direct investment by multinationals (e.g., Hellene, 1983).

As can be seen from table I, the relative role of direct foreign investment tended to fall

moderately in the 1970x, while the mere is a large unsatisfied desire to expand in some LDCs on the part of multinationals that have been frozen out by irrational restrictions imposed by the host nations. In that event mere relaxation of those restrictions could stimulate a significant increase in the flow. While there are some countries in this situation, however, it is certainly not true of all developing countries, and probably not true of very many.

For the remaining countries, the reduction in the incentive to invest stemming from lower growth would have to be more than compensated by increased incentives of some other form. But it is not clear that developing countries would be well advised to give artificial encouragement to multinationals, which would be perceived at home (correctly) as discriminating against their own national enterprises. Direct investment is a particularly costly form of borrowing. That cost can be worthwhile where it brings access to needed foreign technology, products, markets, managerial expertise, etc., but it makes no sense to pay excess rates of return unless they are purchasing some expertise that is lacking domestically.

Neither is it clear that the vaunted flexibility of the repayment terms is of great relevance to the risks of illiquidity such as those that confronted many developing countries last year. Profit remittances decline as profits fall, which generally means as the economy goes into recession, not as it encounters balance-of-payments difficulties. It is presumably some comfort to a country that is deflating because of a payments crisis to know that this will cut profit remittances as well as imports, but this is nowhere near as desirable as an arrangement that would match investment income payments to a measure of ability to pay.

## 4. OTHER TRADITIONAL SOURCES

The other traditional sources of funds are those which appear in table 2: aid, lending by the multilateral development banks (MDBs), suppliers' credits, and bonds.

Flows of aid (official development assistance) from the members of the OECD's Development Assistance Committee have expanded in line with the donors' collective GNP for the last decade, remaining at almost exactly one-half of the official U.N. target level of 0.7 per cent of GNP. This overall constancy of aid flows masks markedly divergent trends: an increase in aid (as a proportion of GNP) in IS of the 17 OECD donors (between 1970 and 1981), versus a sharp fall from what is still the largest single donor, the United States (OECD, 1982, table 1-6). Since there is no sign of any reversal in the longstanding U.S. disenchantment with economic aid, there seems little likelihood of any appreciable expansion in the volume of aid. On the other hand, the U.S. rejection of its former leadership role has so far been accepted with puzzled resignation, rather than with retaliatory cutbacks, by other countries, so that there does not seem imminent danger of a collapse of the aid effort.

Lending by the multilateral development banks also remains constrained by political reservations in the United States. In February 1983 the World Bank announced a "Special Action Program" designed to increase its lending to help compensate for the fall in bank lending. But the sum involved is a mere $2 billion over two years, derisory in relation to the need. The Bank also agreed to raise the ceiling on structural adjustment lending from 10 per cent to 30 per cent, which may help speed up disbursements. This will also help to overcome the other constraint on an expansion of the World Bank's role apart from the lack of political support, namely, the difficulty of presenting enough bankable projects in the form required by the Bank to generate an adequate entitlement to borrow (remembering that the Bank finances only the foreign exchange component of the capital cost). The more serious constraint on the scale of Bank lending operations nonetheless remains that on the supply of funds, rather than that on the demand for them. By far the simplest way to relieve that constraint would seem to be by raising the Bank's gearing

ratio from 1:1 to, say, 2:1- a proposal endorsed inter olio by the Brands Commission (1980). But if one is asking what is probable rather than what is desirable, there is little sign of any disposition to encourage the public sector to assume a markedly larger role in the process of financial intermediation.

Suppliers' credits have provided a constant modest share of the capital flow to developing countries for many years. Since the export industries in developed countries constitute an effective lobby for the maintenance of these credits, there seems little reason to fear that they might be sharply cut back, as Christopher Johnson (1982)
pointed out when fears of bank retrenchment were at their peak. He estimated that government-guaranteed bank export credits amounted in 1982 to some $15 billion, a substantially higher figure than that for suppliers' credits shown in table 2 (which exclude bank loans to the borrower for the purpose of buying the lender's exports). He
Expected most of these loans to be invulnerable to the debt crisis.

The final traditional source of development finance is the flotation of bonds by developing countries on the Euromarkets or the capital markets of developed countries. Johnson (1982) estimated such sales at $3 billion in 1982, maintaining the modest role in relation to bank credits that bonds have maintained throughout the last two decades. In the previous great age of international lending. prior to 1914, bond finance was dominant. The bonds were long-term (typically on the order of 30 years) and carried low nominal interest rates, reflecting the low inflation of that era. In contrast, such bond finance as developing countries have been able to raise in recent years has been on terms more similar to bank credits than to those traditionally associated with bonds. Terms have typically been for less than 10 years, and nominal interest rates have been high, reflecting inflation. (A high nominal interest rate in the presence of inflation does not imply a high real interest rate, but it does reduce the effective
Maturity.) The only major difference between the terms of bond finance and those of bank credits is that the former typically involved fixed rather than floating interest rates, though even that difference has tended to erode in recent years as bonds have increasingly taken the form of "floating rate notes."

## 5. POSSIBLE NON-TRADITIONAL SOURCES

Given the prospect that traditional sources of developmer finance will provide no more than the minimum sum needed to sus?kin slow recovery in the developing countries and the presumption that additional capital flows would have a high yield in terms of the increased growth they could sustain, there is an obvious interest in exploring possible non-traditional sources.

One possible mode of finance that has become quite important in intro-OECD capital flows but not in North-South flows is equilr investment. Unlike direct investment, the investor does not seek control of the enterprise, but merely purchases equity shares with a view to receiving a share of the profits. There is a strong economic motivation fueling cross-border equity investment-namely, the principle of risk diversification. It is a fact that rates of return on equity investments are less closely correlated internationally than they are within an individual country, and therefore total risk can be reduced by selecting a portfolio that straddles national frontiers. This factor is just as pertinent between developed and developing countries as among developed countries and hence there ought to be a natural incentive for investors in the North to seek out equity investments in the South.

A major impediment to transnational equity investment has traditionally been lack of knowledge. Investors find it difficult to appraise the prospects of companies operating in a different country, with its own distinct political and other risks. No doubt this informational impediment will continue to limit transnational equity investment by individuals, but where large sums of money

are pooled, as in unit trusts or pension funds, the rapidly falling costs of information transmission should make foreign investment increasingly easy. Equity investment will also be restricted by the limited size of the private corporate sector in many developing countries. But perhaps the most serious constraint on equity investment in developing countries comes on the dubious practices that abound in too many LDC stock markets. Until there is reasonable assurance that outside investors will not be deprived of their fair share of the return in an enterprise by ruses of doubtful legality and unquestionable injustice one must expect foreign investors to remain wary. Individual LDC governments need to strengthen regulatory procedures to prevent such abuses. It might well prove worthwhile for them to seek advice from Northern regulators. If they decide that they wish to seek increased capital inflows in the form of equity investment, they might also be well advised to invite periodic inspections by teams of independent foreign experts, whose reports would be made public.

It has recently been suggested by Bolin and Del Canto (1983) that an export development fund might be established to fill the gap between commercial bank loans of up to 8 years maturity and World Bank loans of IS to 20 years. They proposed appealing to the selfinterest of the developed countries' export lobbies in order to get the "backing" (i.e., guarantees) of the export credit agencies of the principal industrial countries for what might be a new affiliate of the World Bank. They envisaged this agency using its guarantees to raise floating rate funds from the Eurodollar market, which it would lend for terms between 8 and 14 years to developing countries. These medium-term loans might, they argued, be used for part-financing of a large project, as a part of a package that would also include commercial bank loans covering the shorter maturities and World Bank loans for the longer maturities. The project would be evaluated by the World Bank. and all the loans made to finance it would be linked together by cross-default clauses.

It certainly seems that the shortfall in commercial bank lending might more likely be reduced in this way than by a renewed expansion of direct lending by the banks. The proposal is mercifully free of the acute "moral hazard" problems that afflict most of the ideas for official encouragement of renewed bank lending via the provision of guarantees. It even makes a serious attempt to address the question of harnessing political support for an expanded role for the public sector. At the same time, it would do nothing to reduce the vulnerability of LDC borrowers to variations in nominal and especially real interest rates. There also seem to be strong objections to the introduction of cross-default clauses between World Bank and commercial bank loans, which would threaten the World Bank's preferred creditor status for very dubious gains.

A third possible innovation, advocated by Donald Lesser (1982), is the introduction of commodity-linked bonds. Traditional bonds oblige the borrower to pay a given nominal sum in interest and amortization irrespective of the state of the world. This places on the borrower the whole of the risk that events will differ from those expected when the loan was agreed. On average the borrower will presumably reduce its expected costs of debt servicing by bearing the risk. But this does not necessarily make the bargain a good one. On the contrary, poor primary-producing countries are already uncomfortably exposed to risks from exogenous changes (in the terms of trade, the weather, and so on), and it would seem sensible to seek mechanisms which would allow them to pass a part of those risks on to others better positioned to bear risk. This is what the commodity linked bond is designed to do. Such a bond would promise to pay nominal sums in debt service payments related in a prespecified way to the prices of one or two principal export products. For example. Zambia might issue bonds whose debt service payments were proportionally related to the price of copper. If the copper price halved, so would its interest and amortization obligations, thus providing some relief from the terms of trade loss. Such bonds would seem likely to provide an attractive investment medium (or

hedge, or speculative asset) to those who had a relatively optimistic view of the probable future course of copper prices.

There seem to be no obvious problems in drawing up such contracts, nor any reason to fear that such bonds would pose moral hazards. The only mystery is in understanding why borrowers have not leapt at the opportunity of issuing such bonds.

A final possible innovation that of index-linked bonds is one that I have advocated previously (Williamson, 1982). Instead of interest and amortization being fixed in nominal terms, they would be fixed in real terms. There is no technical difficulty about doing that: a dollar-denominated bond would use a dollar price index (e.g., the U.S. wholesale price index) to calculate the dollar value due on a certain date, while an SDR-denominated bond would use a weighted average'- of the W Pls of the countries whose currencies compose the SDR basket to calculate the SDR value due on a given date. As compared to floating interest rates, indexation would reduce the risks confronting the debtor. The real interest rate and the effective maturity of the bond would be determined at the time the bond was issued, rather than varying with inflation and the course of monetary policy in the developed countries, But commodity-linked bonds also give such protection, and in addition they help offset the risk of changes in a country's terms of trade. Hence index-linked bonds would seem to be dominated so far as the bonds issued by an individual country are concerned,

Where index linking might be expected to come into its own is in an attempt to issue bonds by a collective of developing countries. Such a collective would inevitably contain countries with very different primary product exports, which would preclude simple application of a commodity link.' An indexed coupon might also seem more attractive for very long-term bonds, since the risk of commodity prices deviating widely from the price level due to technological change, or of the commodity composition of a country's exports changing drastically, cannot be excluded in the long run. My own scheme envisaged an existing institution like the World Bank or IMF setting up a new affiliate to act as the agent for such developing countries as wished to join. This agent would periodically (at, say, quarterly intervals) enquire of its members as to how much they would wish to borrow at alternative real interest rates. It would filter those applications with two distinct objects in view: to ensure that countries did not borrow sums that were excessive relative to the long-term outlook for their debt servicing capacity, and to prevent any single country preempting an excessive portion of a single bond issue, so that each such issue would represent a well-diversified portfolio. From this process would emerge a supply (of bonds) schedule: a knowledge of how much its members would wish to borrow at different real interest rates. The agent would then invite bids from potential lenders naming how many bonds they would like to buy at different real interest rates. The point where supply was equal to demand would determine the size of the bond issue.

When 1 first proposed a scheme along these lines in Brazil in 1977 (Williamson, 1977), I was told that it was superfluous because Brazil could borrow all it wanted through traditional channels, and was moving into a position of steadily growing surpluses on current account! Others argued that such a scheme would hurt the LDCs because it would force them to pay positive real interest rates! Then there were complaints that "indexation is inflationary," which are a half-truth that is wholly false when indexation of long-term bonds is a condition for credit flows to carry long maturities. In my view the only serious issue is whether there exist investors who would be prepared to buy such bonds on reasonable terms in large quantities if they were to be issued. There are surely investors who should be expected to welcome inflation-proof long-term assets, namely those who have long-term liabilities whose value they would like to protect against inflation, for instance, pension funds,

insurance companies, and central banks of capital surplus oil exporters.
That such institutions do not invest on an appreciable scale in the Third World seems to be largely due to unfamiliarity. In the wake of the debt crisis, they are probably feeling pleased with themselves for not having become familiar in the past! But in fact that is an uninformed reaction, for long-term investment in development is shown by past experience to be as sound a long-term investment as it is possible to make. Furthermore, if the redundant IMF gold were to be used as the nucleus of a Guarantee Fund which would persuade the investors of long-term funds to get involved in financing development, gold could yet play a constructive role in the world economy.

## 6. CONCLUSION

1 have argued in this paper that traditional sources of finance are unlikely to do more than provide the minimum flow of finance needed to sustain a slow recovery in the developing countries. I see better prospects of increasing the total flow by seeking to develop nontraditional sources than by expanding the traditional ones. Four promising possibilities have been outlined: equity investment (without control), an export development fund to provide medium-term loans in a package with traditional commercial bank and World Bank sources, commodity-linked bonds, and long-term indexed bonds issued by a collective of developing countries. These possibilities are not mutually exclusive. The more that are implemented, the better will be the prospects for the development process to resume its full potential,

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# CHAPTER 10
# Appropriate Intermediate Objectives for the International Financial System
**George Vojta**

The traumatic events of 1981-83 have caused many to believe that fundamental reform of the international financial system is both necessary and achievable. The principal concern in the Group of 10 industrialized countries is the instability associated with floating exchange rates and high and volatile interest rates. Developing countries specifically argue for higher levels of aid and concessional assistance to hasten recovery from the recession, creation by the IM F of additional SDRs to ease debt and liquidity burdens, and the desirability of commodity price stabilization programs and greater access to the developed country markets for Third World exports.

There is a common feeling that Third World debt levels endanger the stability of the international financial system. Proposed solutions range from a general forgiveness of Third World debt to some form of assumption of this debt by governments or multinational institutions. A minority view in the developed countries favors return to the gold standard.

Dialogue between the developed and developing countries continues strident in tone and unproductive in result. Third World advocacy of the new economic order has had limited acceptance by the developed nations, as the events of Belgrade' illustrate clearly. Some speak of an emerging climate of "new realism" or "new pragmatism" in the Third World, but significant progress on the major issues has not occurred.

These concerns underlie the call for Bretton Woods I1. Yet it is disappointing to note the paucity of concrete visions of what such a conference can or ought to achieve. It is not clear that Bretton Woods II is an idea whose time has come. The contention of this analysis is that the current debate needs to be refocused. Today's debate is, in fact, yesterday's discussion; it is dated and not entirely relevant to current circumstances. Today's debate is unreflective of current reality and takes little cognizance of real, potentially significant. reforming initiatives which arc taking place. Today's debate is focusing on the wrong questions. If the wrong questions are on the discussion table, a constructive outcome is unlikely. What is needed is to introduce a new perspective.

The first order of business is to show the invalidity of certain visible issues, in order to pave the way for a more constructive discussion focused on actionable questions.

1.A return to the gold standard is neither feasible, nor is it agreeable to the world community.

The world community will not agree to return to a monetary system which involves special benefit to South Africa and the Soviet Union. The vast majority of states will not accept the automatic, externally imposed adjustment mechanism inherent in the gold standard. The consensus is that the way to achieve stable relative values among the major settlement currencies is by way of sound fiscal and monetary management in the home countries of those currencies. Contrary to concerns about a paucity of world liquidity, the problem is the relatively high price level of gold. The current danger is the inflationary potential of too much liquidity and purchasing power represented by the historically high market price of gold reserves and gold holdings in non-official hands.

2. "The New Economic Order" as currently envisioned by the Third World will not be achieved in any reasonable period of time, because the developed countries cannot agree to these demands, and moreover, do not have resources to do so.

The lingering effects of the global recession, the unemployment consequences of structural economic change and the magnitude of fiscal deficits in the developed economies connote a very limited capacity on the part of the developed countries to act decisively on issues of the new economic order. As a result (ref. the W illiamsburg[2] communiqué), the developed countries will do little unless and until their domestic recoveries have run a considerable course.

3. Exchange rates cannot be stabilized by 'intervention. "

Official intervention has a limited capacity to maintain orderly market conditions only in the very short term. Intervention cannot prevent a major change in a currency's relative value. A fixed exchange rate cannot be maintained by an individual country in an interdependent financial world in which major liquidity pools can cross exchange boundaries without effective limitation. The best hope for exchange rate stability in the major currency countries is the common achievement of low rates of domestic inflation in each country-which is happening today in the United States, Germany, Japan, the United Kingdom and Canada.

4. General debt relief or a general refinancing of Third World debt by a new institution, the IMP,, the World Bank, ere. Is not a practical option.

General debt relief would bring insolvency to the world banking system; the financial capacity and political mechanism to affect a massive refinancing program that would be responsive in a short time frame does not exist. Third World debt must stay with present holders, its quality must be improved, and it must be serviced in ways that do not put lending institutions in an excessively high risk position.

5. Significantly higher aid and concessional assistance will not be forthcoming.

This is so because the developed countries do not have the means or the political basis for it; they are coping still with high levels of national unemployment and fiscal deficits.

6. Commodity Stabilization Fund Programs cannot guarantee or stabilize commodity prices.

As with "intervention" in the foreign exchange markets, the most that can be said for these programs is that they can maintain orderly markets to a limited degree for short periods of time.

7. The current Third World debt difficulties were caused hy:

a. the 1979-81 energy price rise;

b. a simultaneous global recession, unprecedented in the postwar period; and

c. economic mismanagement in individual countries.

The external disequilibrium caused by (a) has ended. Recovery is now established in the U.S. and in other major economies; (c) is being corrected by formal debt restructuring processes for individual countries, which though onerous, burdensome, and dangerous, are succeeding.

The appropriate focus of the panel's discussion is not on issues 1-6 above, but on a series of less ambitious, but very important objectives which are suggested by the 1981-83 experience and the adjustment processes currently under way.

1. In periods of general economic and financial difficulty, involving higher risks to lenders, the institutional lending base providing credit to Third World countries shrinks. Institutions reduce exposure or opt out of the market entirely. Thus our first objective ought to involve initiatives to stop the shrinkage of lending activity and, over time, to broaden the institutional lending base to include other classes of institutions and broader types of credit instruments that can be made available to Third World borrowers. In addressing this issue, Third World countries must understand that this effort involves tapping external pools of savings. The particular credit and investment standards which are required for access to these pools of savings must be understood and respected and can only be liberalized over time by successful experience by the

lenders/investors. New sources of credit are:
- insurance companies in the major economies;
- pension and mutual funds in the major economies;
- multinational corporations; and
- Third World banks and other financial institutions.

Financial instruments which could be used more broadly are:
- bonds;
- Acceptances: commercial paper.

The macro policies required to tap these sources of funds are those advocated by the International Monetary Fund; specific criteria for lending investment by these institutions are established by host country regulators.

Bonds (commercial paper/acceptances require ratings, which involve certain tests of financial soundness applied to borrowers. Few Third World countries are focusing on this issue to the degree required, even though the experience is that soundly managed countries-low or high income-can have and have had access to these sources.

2. No effective secondary market mechanism exists for "sovereign" credits (short- or long-term). Lending institutions that lend to the Third World economies must make a decision to hold the financial assets acquired to maturity. They are unable to liquefy these assets or adjust their country exposure up or down for a reasonable price especially in current circumstances. Orderly secondary market mechanisms must be developed to support every significant primary international credit market, to make these markets more responsive to lenders' needs.

3. Third World debt must subject itself to more systematic monitoring by the new Institute for International Finance (IF), and in due course formal credit ratings must be generated for Third World paper. This is entirely possible as a long-term consequence of the formal debt resehedulings that are taking place. Progress toward formal debt ratings will lead to more proper risk/ rate differentials in the international financial markets. Existing intermediaries should be encouraged to work in this direction.

4. Existing multilateral institutions-the IMF, the IBRD, and the regional development banks-should use market sources of funds to leverage their lending capacity. National financial entities—particularly export-import banks-should use guarantor powers more expansively to make Third World paper playable particularly with new institutional investors at investment grade standards in their home markets. Guarantee facilities of these agencies can also be useful in developing the secondary market mechanisms discussed above. Official lenders, including the Bank for International Settlements (BIS) also can invest short-term funds to support the development of secondary markets.

5. The current round of IMF/ World Bank quota/resource increases should be consummated.

6. A case can be made for a "conditionality" standard that is more appropriate for low-income countries, which reflects cyclical pressures on their foreign exchange receipts. Analysis of this issue should commence within the IMF.

7. The Third World central banking community ought to consider the sponsorship of a new or acquired financial vehicle which would specialize in:

a. making secondary markets for their sovereign credits;

b. facilitating the underwriting of Third World financings to the major external capital pools;

c. supporting the Institute for International Finance in developing
Formal credit ratings for Third World paper;

d. organizing and managing debt rescheduling exercises.

8. Universality of membership in the IMF/IBRD should .be achieved to assure that existing lenders to current non-member countries do not suspend lending activities in difficult risk environments.

The foregoing measures will augment significantly the global processes of reestablishing external equilibrium, economic recovery, and debt restructuring that

are in progress. It is recognized that these objectives do not address the short- and long-term issues of global income distribution and equity, which are major Third World
concerns. But achievement of these objectives along with the extension of the economic recovery (involving expanded levels of trade) will assure that a worldwide growth trajectory is reestablished. This is the precondition to making discussion of issues of equity practical. Progress towards these objectives will recreate a climate of more effective financial intermediation on a global level and facilitate progress on issues such as protectionism and the global relocation of industrial capacity which would be of benefit to the Third World. These initiatives would restore the market as a validating force in the further economic development of the Third World, a factor which recent events have suspended temporarily.

In its widest sense the task in the next two years is to restore confidence, regain commitment to the global financial system, and reinforce the view that all nations have an ongoing stake in the interdependent global economy. Focusing on the suggested set of intermediate objectives is the most effective way to achieve these wider results

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# PART III
# CONCESSIONAL ASSISTANCE AND THE POOR LDCs

"If a decline in [concessional assistance] were to be added to the array of difficulties which [low-income] countries have experienced in recent years, the consequences for growth and development would be severe."
Shahid J. Burki

## CHAPTER 11
## An Overview*
**xhadija Haq**

Although the low-income countries-defined as those with per capita annual income under $600-are not among the biggest debtors in the current crisis, today's economic and financial strains carry especially harsh implications for them and their development. The poor countries are heavily dependent for their external finance on concessional flows-grants and low-interest loans-which, like private finance, have slowed in recent years, although the needs have never been greater. The participants at the Istanbul Roundtable looked at this need for concessional finance, examined the present constraints on supply, and suggested possible approaches by which donors and recipients might expand the supply of concessional resources for the future.

### THE NEED FOR CONCESSIONAL FLOWS

The low-income countries have an acute and persistent need for external resources. Their conditions of underdeveloped human and natural potentials and the continuing burden of absolute poverty among their people make the need for a transfer of resources to them inevitable for years to come. The poor countries are distinguished from the middle-income countries, in that they are and will continue to be heavily dependent on concessional flows. This is inevitable for at least three reasons: the poor countries by definition have little creditworthiness and so no

access to private, non-concessional flows; they generally have low rates of domestic savings; and their needs for alleviation of poverty and for human resource development are severe and immediate.

Of course, even within the group of low-income countries, the problems and needs vary greatly. Some, especially those with enormous populations, such as India, China, Pakistan, and Indonesia, have already joined the development race, with infrastructure and institutions in place. Others, the least developed and sub-Saharan African countries, have not. But all of the poor countries share this: that without adequate flows of aid, it will be impossible for them to attain rates of growth in their GDPs greater than the growth in their populations; and it will be impossible to begin to address the problem of poverty.

The World Bank's World Development Report claims that the low-income countries' GDP has the capacity to grow at 5.5 per cent per annum, if adequate aid were available. In sub-Saharan Africa, aid will have to grow at 6 per cent annually, if per capita incomes are to rise at all.

Despite these obvious needs, concessional resources have become increasingly scarce during recent years, and the development process has ground to a halt in many low-income countries. There are a number of reasons for the shrinking of concessional flows, but it is clear that this trend must not continue, or it will compound the problems of already hard-pressed countries and populations around the world.

## CONSTRAINTS ON THE SUPPLY OF CONCESSIONAL FINANCE

Recent years have seen a decline in overall official development assistance (ODA), perhaps attributable in part to the recession, but also apparently part of a longer-term trend of "aid fatigue," especially in the U.S. and U.K. ODA as a percentage of GNP has been declining in those two major donors, although it has risen and continues to rise in Japan and some European donor countries. Nonetheless, the tradition of "burden-sharing," whereby each major donor maintains a certain proportion of total assistance, makes it difficult for other donors not to follow the path toward retrenchment which the U.S. is taking. For instance, in the current International Development Association (IDA) replenishment, the U.S. is setting a limit of $750 million for its 25 per cent contribution. Other donors have budgeted more, but do not want to reduce the U.S. share below 25 per cent of IDA. And IDA is the chief multilateral finance resource of the poor countries, since other World Bank and IMF funds are limited by quotas and prohibitive conditionalties. Thus, the negative attitude in some donor countries toward IDA is a major constraint on overall aid flows.

Since the early 1970x, the flow of concessional assistance has been turned aside in part by the rising wash of private, non-concessional
finance. A significant share of international finance for developing countries now comes from commercial finance, which flows almost entirely to the middle-income countries. Thus, over the '70s, the poor countries' share of total external finance dropped precipitously. And now, with international concern focused on the middle-income countries' debt crises, there is a great danger that more concessional flows will be directed toward those countries and away from those where human and development needs are more critical.

Not only is the tide of ODA ebbing, but its composition is changing in ways that tend to discriminate against the low-income countries. There is a current trend away from multilateral assistance toward bilateral. This has a number of implications. Of multilateral assistance flows, the low-income countries historically claim 90 per cent; of bilateral assistance, only 40 per cent. Bilateral assistance is often conditioned on political rather than developmental criteria. Furthermore, bilateral aid is often tied, and the real value of such assistance

declines by 30 to 40 per cent. And the trend toward bilateral aid carries a broader threat to development in general-the threat of the regionalization of aid flows, whereby one donor or donor group gains hegemony over one developing region. This is a situation which the international community has been trying to get away from for the past thirty years.

Another constraint on concessional assistance to the poor countries is the form of the aid which does reach them. Conditionality is one problem: the conditions put on much of the multilateral assistance flow are unrealistic or inappropriate for the low-income countries, and the use of the funds is therefore misdirected and inefficient. And there is the issue of project vs. program assistance. Often countries need more general, or program support, but receive specific project grants instead.

The constraints that the poor countries face, then, are: the limited supply of ODA in general; the decrease in their share of total ODA flows; their lack of access to other forms of finance; the shift from multilateral to bilateral assistance; and the conditions attached to the aid they do receive.

## POSSIBLE APPROACHES TO RELEASING THE SUPPLY CONSTRAINTS

One most pressing need for long-term development prospects is the rebuilding of the mandate for aid in donor countries. A great effort
should be made to arouse public interest and seek public support for the aid effort. Appeals should he made to national self-interest, emphasizing the importance of Third World development for the growth of developed economy exports, and to human interests and national responsibility. The humanitarian appeal must be strengthened by demonstrations of the past successes of aid, such as the Green Revolution and the decline in infant and child mortality. Since a perception of aid effectiveness is of paramount importance in gaining public support, all such successes should be made highly visible in donor countries.

Furthermore, although the negative trend in U.S. flows of aid greatly impairs the development effort, the world should not be held a prisoner of the ideology of the current U.S. Administration. In other countries, a new interest in Third World development is flourishing-as for example in Italy, where aid has grown fourfold since 1979. Such enthusiasm should be encouraged and reinforced by support from the international community.

In terms of specific measures to increase immediate supply, one priority is the WA VII replenishment. IDA, the main source of finance for the poor countries, is threatened by a reduction in support from the U.S. lithe U.S. does not change its stand, one possible redress would be the establishment of a parallel account by other donors, in which non-contributors would not have procurement rights.

Another specific measure, which would benefit the poor countries by expanding world liquidity generally, is a special allocation of special drawing rights (SDRs) by the IMF. There have been proposals in the past to make such an allocation and to link the SDRs to criteria of development needs. Through this aid link, the SDR would become an instrument directly affecting the redistribution of world income. However, there are conflicting opinions on whether it is desirable to introduce an aid element into the SDK allocation, if SDRs are intended to become the basis of the international reserve system. And there is the political consideration to contend with, that the allocation will be more easily won if the argument for a link is put aside. There are possibilities for compromise on this issue-for instance, an agreement by developing countries to focus the aid link only on the poor countries; or channeling linked SDRs through IDA; or establishing not a link but a floor for SDRs, to ensure that all low-income countries receive a share of the benefit.

Aside from the parallel account to IDA and the SDR allocation, another important measure for extending the resources of the multilateral institutions to the low-

income countries is a review and reformulation of conditionality standards. In imposing its conditionality, the IMF often has different objectives in view than the objectives of the recipient country. Recipients, especially poor countries, are often weak in the expertise needed to propose and defend alternative instruments. Therefore, a thorough review of conditionality for poor countries is needed, as well as greater flexibility in the objectives, instruments, and schedule of conditionality.

More generally, a renewed overall emphasis on multilateral (vs. bilateral) assistance would greatly enhance the benefit of poor countries from aid flows, since they receive a larger proportion of multilateral aid. Of all ODA, 45 per cent now goes to the low-income countries. Some higher target-perhaps 2/3 of ODA-should be considered for international acceptance.

Furthermore, bilateral aid should be untied as far as possible, to improve its cost-effectiveness. And the mix of project vs. program aid should be reviewed and better adapted to the needs and potentials of low-income recipients.

Another promising source of assistance for poor countries is the great number of non-governmental organizations (NGOs) now providing about R per cent of all concessional resources. The NGOs are especially important to the low-income countries because of their strong emphasis on poverty alleviation and human resource development.

Thus far, all of the approaches suggested redressing the supply constraints are approaches from the donor side: reviving the mandate for aid, IDA replenishment, SDRs, and so on. However, the efforts on the supply side must be supplemented by efforts on the recipient side. Especially, to help rebuild the mandate for aid in donor countries, recipients must take part in emphasizing the importance of aid, particularly multilateral aid, to donor governments, and they must be willing to discuss the sensitive issues of aid use and effectiveness and to take steps in correcting their domestic policies, since doubts on this score are blocking aid flows significantly.

Furthermore, recipients can increase the effectiveness of the aid received by hardening their standards for receiving assistance, especially technical assistance. Much of imported technology and expertise are inappropriate to specific country needs, especially in current rural

Development projects. Expertise should be sought and developed domestically, where possible, and Third World countries should cooperate with one another in providing technical assistance and

Developing human resources.

# CHAPTER 12
# Flows of Concessional Assistance: A Catalogue of Issues

**Shahid Javed Burki**

## 1. INTRODUCTION

The issues of aid volume have to be addressed with several fundamental perspectives in view: (i) the growth prospects of the developing countries; (ii) the resources which developing countries require for development; and (iii) the willingness or ability of donor countries to meet a part of the developing countries' resource shortfalls by providing concessional resources.

Recent growth rates in the poor countries that are heavily dependent on concessional resources have been unacceptably low-unacceptably, because at these levels there is no hope of alleviating the problem of absolute poverty in many low-income countries, particularly in sub-Saharan Africa, where negative rates of per capita income growth have been experienced. In sub-Saharan Africa, average

per capita incomes have now declined below the levels that existed at the time these countries achieved independence. It would require about a 2 per cent annual per capita growth rate to recover those levels by the end of this decade. While there can be no totally objective criterion to judge minimal acceptable growth performance, no rate short of 2 per cent could be declared satisfactory. In contributing to such growth, concessional resources have a major role to play. For example, the World Bank's report on Accelerated Development in Sub-Saharan Africa estimated that official development assistance (ODA) would need to grow at an annual rate of about 6.6 per cent to bring about a per capita growth rate of slightly over 2 per cent (when accompanied by policy reforms in African countries). In low-income Asian countries as well, satisfactory rates of economic growth are closely related to flows of concessional resources.

Concessional resources are one among several resources for development. Domestic savings constitute one such resource. Export proceeds are another. Non-concessional flows and private investment are also important. Analysis of trends in recent years indicates that many low-income countries have experienced shortfalls in one or another of these diverse resources for development. Trade is an example. A stagnant international economy, resurgent protectionism in developed countries, the declines in commodity prices, and the

Deterioration in terms of trade all have reduced the developing countries' resources for development derived from exports. As a consequence, their ahilky to import goods essential for development has been concomitantly constrained. Non-concessional flows have slowed dramatically over the past year. Where they were substantial in the past, they have led in many countries to severe debt servicing difficulties with attendant weakening of creditworthiness- Savings and investment rates in many low-income countries have historically been very high, so that-in the absence of the receipt of significant amounts of external resources-to increase them further would be at the expense of already low consumption levels. In this difficult context, concessional resources have a crucial role to play in providing low-income countries with the requisite resources for development. If

a decline in aid were to be added to the array of difficulties which such countries have experienced in recent years, the consequences for growth and development would be severe.

While these trends have been apparent in many recipient countries, many donors have also been experiencing serious financial difficulties which have had an impact on aid budgets (although such budgets remain a small percentage of central government budgets). This has compounded the problems of the developing countries. At precisely the time when adverse developments have heightened the developing countries' requirements for concessional resources to mitigate constraints on their other resources for development, many suppliers of such resources are finding it increasingly difficult to provide them. As a result, it appears that the gap between what recipients of official development assistance require and what donors will provide will continue to widen unless corrective action is taken soon.

What are the alternatives in this situation? There are a number ofoptions, including the following:

Accept loner growth and related austerity measures in developing countries. As noted, recent growth rates in many countries have already been unacceptably low. Obviously, tolerating further reductions with the even more severe austerity this would entail would thereby also reduce the "need" for concessional resources below what it would be under moderate or high growth scenarios. It must be asked, however, what the consequences of this would be for recipients, in economic as well as social and political terms, and for donor countries in costs to them again in economic as well as in social and political terms.

Increase supply from donors. An alternative approach, definitely preferable from the development standpoint, would be to encourage donors to increase their aid supplies markedly in the years immediately ahead. As is apparent in the ensuing discussion of prospective supplies, however, there does not appear to be much

scope for significant increases from either bilateral or multilateral providers of aid, because of the weakening in the mandate for aid. If donor governments are willing to reinforce the aid mandate, they must address the issues of political constraints on aid and burden-sharing among donors.
"Match" aid requirements with aid supplies better. Apart from aggregate volume, an important issue is the pattern of allocation of concessional flows and how well it is matched to the requirements of the various recipient countries. Another important issue is the appropriateness of the current mix of aid (project/non-project, etc.) to the kinds of resources which countries require for development. A better allocation or better mix of aid might help balance the requirements of recipients with the supplies of donors.
"Stretch" available supply as much as possible. In this regard, it needs to be asked: (i) how much "stretching" should occur (e.g., the hardening of presently soft terms, greater cofinancing with nonconcessional flows, better management and use of available funds, etc.), (ii) what the effects might be on recipients and on donors; and (iii) the relative efficacy of multilateral and bilateral channels as well as possibilities for more effective interaction/coordination between them.
Finally, attention needs to be given to the relationship of aid volume to broader developments in the international economy. What role might concessional resources have to play, for example, in a global recovery program?

## 11. THE REQUIREMENTS FOR AID AND POTENTIAL OF INCREASED AID

Aid augments domestic resources; provides access to foreign resources, thereby easing foreign exchange constraints on development increases total factor productivity in the recipient; has various catalytic effects that contribute to development; makes specific, projected contributions to development; and contributes to the adoption of more efficient and effective policies. In terms of its effects on donor economies, aid benefits exporters in donor countries directly through procurement under aid-financed projects; increases exports from donor countries as growth occurs in recipients and they import more; facilitates private investment; and contributes to the maintenance of “global systems” from which all countries-donors as well as recipients-benefit.

In light of these numerous and diverse contributions of aid, it is extremely difficult to state in a precise, quantitative fashion how much aid is needed to fulfill its objectives. There are various methodologies for estimating needs, but this is not the place to discuss them in detail. The pros and cons of these-such as the “two-gap” models widely employed to estimate the import and investment constraints on growth-are well known to the development community. Despite the difficulties, it is possible to make some estimates of need based primarily upon aid’s contributions to developing countries’ import requirements, investment requirements, and growth prospects. The following materials briefly summarize aid’s contributions in this sense.
The World Bank’s 1983 World Development Report projected high, central and low-growth scenarios for the growth of GDP from 1985 to 1995. According to the central scenario, for all developing countries, GDP would grow by 5.5 per cent per annum in the period 1985-95. For the low-income oil importers of sub-Saharan Africa, GDP growth would be 3.3 per cent. For the low-income oil importers of Asia, the rate of growth would be 4.9 per cent. The realization of the central scenario is contingent upon a number of assumptions: these include a growth rate of 3.7 per cent in the GDP of industrialized countries, 6.8 per cent increase per annum in the exports of developing countries, a slight improvement in the terms of trade of the developing countries, an increase of 10 per cent per annum in net capital flows to the developing nations, maintenance of domestic savings rates by the developing

world at 24 per cent of their GDP and a return on investment in these countries on the order of 20 per cent. The Report assumes that concessional flows-one component of capital flows to the developing countries-would increase at the rate of 9.9 per cent per annum in nominal terms or 3.5 per cent in real terms. In other words, for the low-income countries to achieve the modest growth in their GDP suggested by the central scenario, ODA flows as a percentage of the GOP of the donor community would have to remain at the level of 0.35 per cent reached in the early eighties.

The Bank report on Accelerated Development in Sub-Saharan Africa concluded that a significant increase in aid (a near doubling in real terms) could increase per capita incomes in oil-importing Africa by nearly one-quarter during the coming decade compared with virtual stagnation without it. With a substantial aid increase (together with policy reforms in African countries), GOP per capita could grow by 2.1 per cent per annum or two percentage points more than the per capita growth rate assumed in the central scenario of the 1983 World Development Report.

Statistics assembled for the Africa report demonstrate that there were 17 sub-Saharan African countries in which, in 1979, net ODA disbursements were more than 50 per cent of gross domestic investment. (In five countries, they were more than 100 per cent of GUI.) For the low-income countries as a group, excluding several special cases (defined in the 1982 DAC Chairman's Report to include Indonesia, Indochina, and Egypt as well as the two large cases of India and China), aid is the equivalent of 8 per cent of their GNP, almost 40 per cent of their current imports, and more than half of their investments. For the officially designated least developed countries, aid corresponds to 10 per cent of their combined GNP, 50 per cent of their current imports, and 80 per cent of their investments.

The Bank's study on fad in Retrospect noted that, in 1970, QUA (lows covered more than 90 per cent of the current account deficits of low-income countries. In 1980, despite the burgeoning deficit of many of these countries, ODA flows still covered 65 per cent.

From the foregoing, it is possible to state with a considerable degree of confidence that aid responds to some of the main develop
mental needs of recipients. Simply put, a larger supply of aid would enable recipient countries to import more from donor countries, to
Invest more, to grow faster, and to provide more scope for im
Provements in equity.

## III- SHORT-TERM ASPECTS OF EXTERNAL RESOURCE REQUIREMENTS

The deterioration in recent years in the economic situation of the developing countries has been well recorded in a number of documents prepared by the World Bank, the IMF, UNCTAD, the UN, etc. The documents show the following trends:

- a 25 per cent deterioration in the terms of trade of low-income countries between 1979 and 1982;
- a drop of 25 per cent in the World Bank's overall index of 33 commodity prices between 1980 and 1982;
- reduced import levels in low-income countries for three consecutive years;
- an increase in the total outstanding medium and long-term debt of developing countries from about $350 billion in 1979 to about $530 billion in 1982; and (as a result of all these)
- cutbacks in investment plans, slowdown of ongoing projects, and shortages of funds to finance the operation and maintenance of existing facilities. Accordingly, the short-term adjustment needs of the low-income countries appear extremely severe. The UNCTAD Secretariat re

cently estimated them at $70 billion in 1983 and 1984 only to restore the liquidity position of developing countries to its end-1978 level and to provide additional imports needed to renew the momentum of growth. The current economic and financial situation confronting the low-income countries raises several important questions:

- Are the short-term adjustment needs of the low-income countries additive to their medium and long-term development needs? Can they be supplied additively? If not supplied additively, are they in displacement of the medium and long-term development needs? If displacing, what would be the effects on growth and development in the low-income countries?
- Can medium and long-term growth resume without short-term adjustment, which clearly is of the utmost urgency and priority?
- What role might eoneessional resources play in promoting re covery from the present crisis? What are the implications for: the percentage of total project/program costs financed by aid, the fi nancing of local costs, the financing of the costs of operation and maintenance of projects, the forms of assistance (e.g., project/nonproject, structural adjustment, etc.), and related matters? Resource requirements, therefore, have a qualitative as well as quantitative dimension in the current context. What measures might be taken to address these requirements? For example, should there be other programs of special assistance analogous to or more expansive than the World Bank's program recently announced?

## IV. THE SUPPLY SIDE

### (A) Bask trends in ODA

The highlights of a retrospective assessment of supply of eoncessional flows include the following:

(I) Annex table I shows the absolute amounts of ODA (net disbursements) for selected years from 1970 to 1981 for all donors, and in 1982 for the DAC countries (in millions of 1981 dollars). The volume of ODA from DAC member countries grew by nearly 4 per cent annually in real terms over the whole of the past decade, fell sharply by 3 per cent from 1980 to 1981 and rose by about I I per cent from 1981 to 1982. The table illustrates the dramatic growth of OPEC aid, although this, too, declined between 1980 and 1981. CMEA aid, as is apparent from the table, virtually stagnated throughout this period.

(2) With respect to comparative volume performance, the basic data are presented in Annex tables 2-6. The total DAC ODA/GNP ratio, which remained virtually unchanged between 1970 and 1982, conceals sharply varying developments in individual countries. The Nordic donors markedly increased an already relatively high share. Another group of countries rapidly increased their share of ODA as a percentage of GNP. Others had ODA marked by slow growth or decline as a percentage of GNP. OPEC countries registered dramatic gains up to 1975, but by 1981 the ODA/GNP ratios for all major OPEC donors had plummeted from their 1975 highs. CMEA aid remained more or less constant as a percentage of GNP.

(3) Viewed in absolute amounts, there were likewise some dramatic developments. For example, from 1970 to 1982. in constant 1981 prices:

- Dutch aid grew from $628 million to $1,487 million (net disbursements);
- Norwegian aid grew from $118 to 573 million;
- Swedish aid grew from $312 to 1,128 million;
- German aid almost doubled in real absolute amounts: - Japanese aid more than doubled;
- French aid grew substantially, whether including or excluding aid to the overseas departments and territories;
- however, U.S. aid slightly increased in absolute amounts between 1970 and 1982, and aid from the United Kingdom has declined after apparently peaking in 1979.

(4) Aid appropriations remain a small percentage of most central

government budgets (see Annex table 7). In 1981, they ranged from 0.4 per cent of such budgets (in Austria) to 3.0 per cent (in France). In some countries where total aid grew substantially in the 1970s, aid appropriations as a percentage of central government budgets actually declined (e.g., France and Sweden).

(5) An important trend throughout much of this period was the sharp growth of multilateral programs (see Annex tables 8 and 9). In 1970, total ODA contributions to multilateral development agencies and funds from DAC member countries represented only 16.1 per cent of all DAC ODA. By 1978 this had reached 30 per cent. However, after 1978/79 the rate of growth of multilateral contributions slowed sharply. While multilateral contributions grew by 13 per cent per year between 1970 and 1975/ 76, they grew by only 1.1 per cent per year between 1978 and 1980/81. As a result, the percentage of total DAC ODA represented by contributions to multilateral agencies and funds was back down to 22.6 by 1981. The point is an obvious but basic one: multilateral resources, discussed in greater detail below, are essentially derivative of bilateral donors' budgetary allocations where coneessional resources are concerned.

**(B) Likely prospects**

There are two major questions under this heading. One is the likely aggregate level of aid as well as the amounts in prospect from the major donors. The second is the allocation of these aggregates between bilateral and multilateral programs.

It is obviously difficult to make precise country-by-country projections, since much will presumably depend upon the vagaries of national economies in the years ahead. Annex table 10 presents the best available information on the prospects from DAC donors. DAC has summarized the situation as follows:

Aid prospects for individual DAC members continue to be highly diversified. As a result of recent government decisions major increases in aid are expected from France, Italy and Japan. The group of 'frontrunners' (Denmark, the Netherlands, Norway and Sweden) can also be expected to achieve further increases in aid. However, public expenditure forecasts in the United Kingdom indicate a decline in aid during the financial year 1982/83, with a slight rise in cash terms in the following two years. Prospects are for a stabilization of United States aid at the current level, although a further decline could occur. There may he little or no growth in Germany's aid. Altogether, total DAC aid disbursements are expected to recover in 1982 by more than the 1981 decline. In the medium term, however, the prospects are for a considerable slowing down in aggregate DA C aid growth, especially in real terms compared to the 4% average annual growth rate achieved during the past few rears. I irIualh• all DA C members face extreme/e serious economic and budgetary situations. This is bound to affect public discussion on aid There is no comparable estimate for the future of OPEC and CMEA aid. It appears likely, however, that in the light of the decline in the price of oil, there will be a continuing decline in the volume of OPEC aid. As for CMEA aid, never large in an aggregate sense, it is unlikely to see major changes in volume one way or the other.

It is likewise difficult to be precise about the future bilateral/ multilateral breakdown of aid. As is apparent from the following discussion of the future of multilateral programs, it does not appear that the multilateral outlook is especially sanguine. A number of major donors, most notably the United States, have indicated a growing preference for bilateral aid. Thus the decline in multilateral aid as a percentage of total ODA, a trend observed for the past four or five years, is unlikely to be arrested soon.

**(C) The multilateral outlook**

The prospective supply situation with regard to major multilateral donors may be summarized as follows:

(I) International Development Association (IDA). 1DA is faced

with a high degree of uncertainty with respect to future funding. Since November 1982, the IDA Deputies have exchanged views on matters such as IDA credit terms, allocation criteria, burden sharing, and size of the seventh replenishment. A significant number of donors have strongly supported the view that IDA's ability to transfer real resources under IDA 7 should be no less than that agreed to under IDA 6, although the major donors have not yet accepted this view.

Donors recognize that China's membership has added I billion more poor people to IDA's constituency and that the resource needs of the poorest countries, primarily in sub-Saharan Africa, for essential development investments are now significantly greater than earlier envisaged. Other donors have expressed the view that, while the replenishment should be large enough to sustain IDA's annual lending

operations at reasonable levels, the funding difficulties faced in IDA 6 and the serious budgetary difficulties which all donors now confront must be taken into account.

The Association's management has strongly urged donors to consider the crucial needs of recipient countries and to negotiate a seventh replenishment allowing for some real increase in lending over and above levels agreed to in 1979. It has suggested that an IDA replenishment level of $16 billion would represent the minimum level of resource requirements for it to (a) address the needs of recipients and (b) maintain a credible operating profile, particularly in countries such as India and China, where, without a meaningful IDA program, the Association's ability to influence policy changes might be jeopardized. This is particularly important in light of the program reductions which were necessitated by IDA 6 funding difficulties. These resulted in IDA's cutting back resource flows to needy countries when they were struggling to adjust to particularly unfavorable developments in their external environment.

(2) Asian Development Fund. The replenishment level of ADF IV for the period 1983-86 was agreed at $3,205 million, based on an average of the daily exchange rates during the first three months of 1982. This compares with the original request for a replenishment of $4,100 million, i.e., 79 per cent of the amount requested. It is, however, noticeably larger than the level of ADF III (1979-82) which was originally set at $2,150 million (but which was reduced to $1,841 million in terms of exchange rates as of September 30, 1982, owing to depreciation in the values of the major donors' national currencies against the U.S. dollar).

(3) African Development Fund. The negotiations for the Third General Replenishment of the African Development Fund (AfDF) for the period 1982-84 resulted in subscriptions totaling about $1,120 million. This level of replenishment fell short of the proposed amount of $1.8 to 2.0 billion deemed necessary for the AfDF to play a significant role in the development efforts of its member countries. The president of the African Development Bank has since been seeking ways to increase resources, but mobilizing this has been difficult. The Bank is also now working on proposals for the Fourth General Replenishment of the Fund. However, if the present unfavorable aid environment persists, it would be difficult to mobilize resources that would ensure continued momentum in Fund operations.

(4) Fund for Special Operations (of the Inter-American Development Bank). Recently the Board of Governors of the Bank recommended a resource increase of $703 million in its Fund for Special Operations, its concessional lending facility. The Board also authorized creation of an intermediate Financing Facility through which eligible member countries would have access to resources which it is estimated will be sufficient to decrease by up to 5 percentage points the interest rate on loans from the

Bank's capital resources up to a total of $800 million. Thus, effective interest rates on these loans would fall to an intermediate point between the Bank's capital rate and that for its Fund for Special Operations.

(5) Intentional Fund for Agricultural Development ((FAD). Appropriation delay on the part of the United States has affected the payment of contributions by some member countries and threatens to delay negotiations on the Second Replenishment of IFAD's resources, due to begin in mid-1983. As a result of this delay, the Fund has been forced to curtail its 1983 program from $435 million to $300 million, which in nominal terms will be 20 per cent lower than the level of $360 million reached in 1981- Even with this reduced level of activity, the Fund will run out of resources by the middle of 1984, and unless new resources become available during 1984, the Fund may have to suspend its lending activities.

(6) United Nations Development Programmed (UNDP). After achieving a 14 per cent annual growth in resources in the last half of the 1970s. UNDP set the same growth target for its third planning cycle, 1982-86. Actually, contributions have been essentially flat (even in nominal terms) since 1980 (at a level of approximately $700 million annually). UNDP has based its country programs and indicative allocations for 1982-86 on the assumed growth targets. As a result of the deficiency of contributions, country allocations had to be cut at the end of last year to 55 per cent of the original country targets. UNDP's financing picture has been complicated by the relative strength of the U.S, dollar in recent years. A number of major donors have increased contributions significantly, only to see the increases substantially vanish when translated into U.S. dollar figures in which UNDP keeps its accounts (most UNDP obligations are denominated or payable in dollars).

(7) The European Community. ODA disbursements by the European Community, besides its member states' bilateral aid and contributions to multilateral development institutions, amounted in 1981 to $1.7 billion. Provisional figures indicate a disbursement level $1.6 billion in 1982. The planned level for 1983 is $1.8 billion. T 1981 disbursement level was over twice the 1978 level ($800 million and over three times the 1977 level ($550 million). In both 1981 at 1982 disbursements were almost equally divided between the Eur peas Development Fund (the grant and soft loan window of ti Lome Convention) and the EC budget, through which financing provided to non-Lome countries and to the world food program Food aid alone represented over $600 million.

(8) OPEC/Arab multilateral agencies. Concessional disburse menu by these agencies in 1981 represented only 6 per cent of ne concessional receipts by developing countries from OPEC sources despite the fact that such multilateral disbursements increased foi the third consecutive year (to $415 million). This increase in 1981 disbursements resulted from a pronounced acceleration of the OPEC Fund's activities, since net concessional disbursements from the Arab Fund, the Arab Bank for Economic Development in Africa, and the Islamic Development Bank were decreasing or only modestly increasing. By 1981 the share of the OPEC Fund in total ODk by OPEC Arab multilateral agencies had reached three-fifths.

**(D) Another source of supply private voluntary contributions from non-governmental organi.otlons**

In addition to the official bilateral and multilateral programs There is another source of supply which is often overlooked. This is "Private aid"-assistance provided by non-governmental organize-a Boos (NGOs). In 1981 assistance from NGO5 in the DAC countries Totaled $2 billion. This marked more than a doubling (in current dollars) of the amount of such private aid in 1970 ($860 million).

Again it is difficult to state with precision what the total amount of this aid might be

in the future, since the totals represent accumulations from numerous and diverse sources. Nevertheless, it does appear C likely that such private aid might grow significantly in the future. In the United States, for example, such growth would be congruous with the present Administration's emphasis on the role of the private sector in development. Whether it will increase significantly beyond
its 1981 proportion of about 8 per cent of aid from all official sources is, however, debatable.

## V. SOME ALLOCATION/DISTRIBUTION ISSUES

Closely related to the question of the aggregate volume of concessional flows are issues related to their allocation or distribution. Inter-country allocation of aid is one such issue. Distribution among countries grouped according to income levels is another related one. There is a time dimension to aid requirements, so that attention must be given specifically to allocations to meet the short-term requirements of developing countries and allocations to meet medium- and longer-term needs. There is also a sectoral dimension to allocation issues, since aid requirements vary by recipient sectors. As a practical matter it is not possible to separate entirely such issues as the requirements of the sub-Saharan African countries from the requirements of the least developed countries, or to analyze the requirements of the two low-income giants-India and china-separately from those of the remainder of recipient countries. For analytical purposes, however, at least the following intercountry allocation
issues may be identified:

### (A) Aid allocation to low-income countries

The criteria for identifying such countries vary from one source to another. For the purposes of IDA lending, for example, the cutoff point for lending is a per capita income i $79t5 in 1 Boa liars are the classificatory scheme of the DAC, those with per capita incomes below $600 in 1980 dollars. In the World Bank's 1983 World Development Report, low-income countries are defined as those with per capita incomes below $410 in 1981 I dollars. Using the DAC's definition, low-income countries received approximately 49 per cent of net disbursements of DAC members' bilateral ODA in 1981. This was a drop from about 55 per cent in 1974. The overall aid going to low-income countries, including the imputed share of multilateral flows, was about 57 per cent of total aid in 1981, almost identical to 1974. An important issue, therefore, is whether or not an increasing proportion of concessional assistance should be directed toward the low-income countries.

### (B) Aid allocation to the least developed countries (LLDCs)

The least developed countries constitute a special subset of all lowincome countries. At the 1981 UN Conference on the Least Developed Countries, the goal was elaborated of devoting 0.15 per cent of donor-country GNPs in ODA to these countries by 1985. At present, however, only 0.04 per cent of DAC members' GNPs devoted bilaterally to the LLDCs and only 0.08 per cent, if t imputed share of multilateral flows is included. Seventeen per cent bilateral ODA from DAC countries currently goes to the LLD( about 22 per cent including the imputed share of multilateral floe So yet another important issue is, What is an appropriate share
total ODA flows for the least developed countries?

### (C) Aid allocation to the sub-Saharan African low-income countri,

The share of the sub-Saharan African low-income countries i concessional resources (such as those from IDA) is expected t increase in the next few years in response to the urgency of the nee and the donor community's increasing concern for the region. The World Bank's report on sub-Saharan Africa suggested a "substantia aid increase" representing an almost fourfold increase in net dis

bursements of ODA to Africa between 1980 and 1990-from $4,5 billion to $17.8 billion—a near doubling in real terms.

**(D) Aid allocation to India and China**

The aid needs of India and China pose a crucial issue for the development community. Is there any agreement on what would be a warranted flow of aid to these two giant low-income countries? If they were to be restricted from ODA on the grounds that, without such restrictions, they would together unduly monopolize flows, what would be the financial consequences for India and China of increasing recourse to capital-market borrowing on non-confessional terms? Would these consequences be likely to differ for each country?

**(E) Aid allocation to other low-income countries of Asia**

What are the allocational implications for Bangladesh and other countries in the Asian region of alternative allocations for subSaharan Africa or India and China? How can the requirements of other very poor countries in the Asian region be reconciled with those of the ODA recipients previously cited?

## VI. POSSIBILITIES FOR INCREASING VOLUME

Some possible issues for discussion under this heading include the following:

(I) The established ODA/GNP target of 0.7 per cent and the current status of donors with respect to it; likely movements toward or away from the target in the near and medium-term future (see Annex table 10).

(2) Various possible supplementary, interim, or alternative targ s, goals, or operational objectives. One example advocated in the past, particularly by Belgium, would be to commit a designated percentage of donors' annual GNP growth increments to aid. A related suggestion is that the proportion of income growth devoted to assistance be graduated according to the rate of growth of income. (Instead of insulating aid flows from donors' cyclical experience, however, both of these measures would have the disadvantage of making them more sensitive to it.) There have also been generalized suggestions for targets based on the needs of recipients (rather than on GNP of donors). And it has been suggested that, within or supplementary to the 0.7 per cent ODA/GNP target, similar targets be adopted for poorer subgroups of developing countries. One such target-that for the least developed countries-has, as noted above, broached a similar target (035[1]perr centpoftGNP) for the Chairman Broader group of low-income countries.

(3) The existence of realistic possibilities for mobilizing additional aid resources in other ways than through conventional budgetary channels.

(4) More innovative sources of financing: some type of international taxation, the allocation of SDR5 for development finance purposes, etc.

(5) A more appropriate burden-sharing pattern, which might result, inier a/ia, in an increase in the total flow of resources.

## VII. AN ADDITIONAL ALLOCATION ISSUE: POSSIBILITIES FOR BETTER MATCHING OF

RECIPIENTS' NEEDS WITH DONORS' SUPPLY

Aid volume issues are related to aid allocation issues in yet another way. Part of the apparent gap between aid requirements and aid supplies may be attributable not to an excess of requirements or deficiencies of supply, but to a "mismatch" between the requirements of many recipients and the supplies of many donors. The argument has several aspects.

Donors have multiple motives for supplying aid. Aid is frequently supplied without much attention to explicitly developmental objectives; rather, at times, it is politically motivated directed toward r'sststance and the Poor LDCs furthering

the national security or other political interests of don There is nothing illegitimate about such non-developmental mott lions, but the fact remains that much aid might therefore be direc toward countries which, speaking strictly in terms of their Bevel, meet requirements, need the aid less than other, less countries. (Such a situation may not unfair) the allocations from Australian, French, y be said to character grams, among others.) And U.SS bilateral p another aspect is the concentration of aid on a few recipie countries, which largely characterizes the allocations of some donor Much Nordic bilateral aid, for example, is concentrated on a reh lively small number of "program" or "partner" countries. Muc OPEC and Arab aid is similarly concentrated. Again, there is n intent here of disputing the legitimacy of the motivation for sue] country concentration. In some cases, it represents an heighten the impact of a relatively small amount and effort tc in some the recipient countries tend tofhave rlarge concentrations of the poor and needy, However, this system runs some risk of introducing cumulative inequalities into the allocation of aid, if there is too much overlapping of the countries u
aid is concentrated. Analysis of the 30 Upon which amounts of aid in iD.cA very recipients receiving the largest absolute correlation between GNP ggcsnve. It reveals a high. General, the per capita and ODA receipts p~ capita. Positive
higher a country's GNP per capita, the higher its ODA receipts per capita. This would appear to run directly counter to the allocation that might be thought desirable if aid were to be allocated strictly on the basis of relative needs (see Annex table 12). The following associations are revealed in this analysis:
There are mom Countries which are loin in GNP per capita and also low in ODA per capita. They include: Bangladesh. Burma, India, Indonesia, Kenya, Pakistan, Sri Lanka and Zaire. • On the other hand, there are a number of countries what high in GNP and oleo high in ODA per capita. These include Israel, Jordan, Lebanon, h are '
Martinique, Papua New Guinea, Reunion, and Syria - There are ren' few countries where the association ght
thought indicative of a needs-based allocation. Of the 30 countries studied, these cases appear to be limited to Somalia, which, for
Example, rated 28 in GNP (i.e., very low) and 6 in ODA (i.e., quite high), Kampuchea, Mali and Tanzania.
• Similarly, there are very few recipient countries where a relatively high level of GNP is associated with a relatively low level of ODA. In the study, these were limited to Morocco (9 in GNP and 18 in ODA), the Philippines (II and 29), and Turkey (4 and 22).
It must be reiterated that further analysis of this subject is necessary. These data suggest the need for an alternative criterion for aid allocation that could serve to correct some of the imbalance between demand and supply. Ways in which developmentally and non-developmentally allocated aid could be at least partially harmonized might also be considered. The result would be an allocation of concessional flows more in line with the development requirements of recipients.

## VIII. "STRETCHING" A FIXED OR SLOWLY GROWING SUPPLY

A number of topics suggest themselves under this heading. They include:

**(A) Possible strategies for coping with constrained supply**

(I) Non-developmentally motivated bilateral aid: are there realistic possibilities for limited reallocations of it or for making it serve developmental goals better?
(2) Terms adjustment: further hardening of soft/hard mixes to other than the poorest countries? Hardening of IDA and the terms of the soft-loan affiliates of the multilateral development banks?
(3) Compromising on multilateral untying? (Model: the IDA special fund)
(4) Accelerating disbursements without losing effectiveness? How should this be done? Is the recently approved World Bank special action programs a model for

others to follow?
(5) Reconsideration of the use of donor contributions to the multilateral development banks (for IDA-like purposes) to subsidize interest on principal raised in the markets?
(6) A harder look at the possibilities of constructive, pro-developmental uses of food aid?
(7) An analysis of the amount of military assistance versus the amount of development assistance, and some demonstration of what even a limited reallocation of military assistance could mean for development?
nssrstance and the Poor LDCs
(g) Stretching OEM through more imaginative linkages with the private sector?

(B) The geographical dimensions of coping
(I) If there is indeed to be priority on Africa, how can augmented ODA to the region be more effectively absorbed? What sequence of human resource building, self-help, and improved coordination could accommodate the increased ODA needed if the region is to grow at even modest rates?
(2) Might it be necessary to allocate ODA to India and China below their "warranted" levels but with the understanding that they
would deserve more ODA in the medium term if and when the aggregate flow increases?
© The hi/aerial/multilateral dimensions of coping
(I) In a likely situation of constrained resources, what priority should be given to IDA? to the concessional facilities of the regional development banks? to other multilateral instrumentalities?
(2) What might be the developmental implications of donors' devoting proportionately more resources to bilateral aid and proportionately less to multilateral aid?

## IX. CONCLUSIONS

(A) While the demand or need for aid on the part of recipient countries may be somewhat mitigated by its more effective use, by improving complementarily with other flows, by greater coordination of assistance on the part of donors, and by a more equitable pattern of aid allocation, the possibilities for the further reduction of the need of developing countries for concessional resources are not particularly viable or realistic. The reason is simple: in most lowincome countries, constraints imposed upon import and investment levels as a result of austerity and adjustment programs in recent years have already resulted in such a slowdown of growth with its attendant side effects that the imposition of even more severe constraints (such as would be entailed by reducing aid still further) would appear intolerable. Greater austerity would appear counterproductive to development in specific countries as well as to the general interest of global recovery.
(B) While the practical constraints on donors' supply of aid resources must certainly be acknowledged, it should also be emphasized he Shahid Jawcf Burki/page I
That the aid budget constitutes a small proportion of the overall budget in virtually all donor countries. This suggests that much of tee Supply situation confronting ODA may be essentially political in m d tore. The mobilization of the requisite political will and the assertion. p of the requisite political leadership could in principle serve to ameliorant
I ate some (though by no means all) of the supply constraints.
© The preceding discussion has demonstrated the close relation. ship between the adequacy of aid volume and the adequacy of current patterns of aid allocation. A supply of aid which was more rationally allocated among needy countries and more develop
mentally oriented could make the aggregate supply constraint somewhat easier to

tolerate.
(D) The suggestions for “stretching” scarce ODA, particularly those involving the hardening of blends and terms, might a[ first glance seem attractive alternatives. Nevertheless, it must be asked what the effects of some of these stretching devices would be on the net transfer of resources and the creditworthiness of recipients. For example, the World Bank’s !DA in Retrospect study notes that in some years, IDA’s net transfer of resources to developing countries has been greater than the Bank despite the Bank’s overwhelming edge in gross disbursements. This is obviously because of the sub spatial difference between the Bank’s interest rate and IDA credits’ service charges, The advantages that concessional flows have in

## ANNEX TABLES

I. ODA, Absolute Amounts, 1970-1982
2. Comparative Volume Performance. 1976/77-1981/82
3. Net Official Development Assistance from DAC Countries to Developing Countries and Multilateral Agencies, 1976-82
4. ODA, Percentage of GNP, 1970.1982
5. ODA, Percentage Changes, 1970·1982
6. Concessional Assistance by OPEC Members, 1970198,
7. ODA Appropriations in Central Government Budgets
8. Growth of Multilateral Contributions and Total ODA
9. Loan and Grant Disbursements by Multilateral Agencies I0. Present Position of DAC Members Regarding the 0.7 Per Cent Aid Target
II. Private Voluntary Contributions, 1970-1981
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12. O8 A Per Capita of Thirty Largest ODA Recipients,
Sources: Tables I-I I, 1982 Review, Development Cooperation, OECD. 1982 figures are from an OECD press release, June 1983, Table 12: World Bank Atlas; OECD, Geographical Distribution of Financial Flows to Developing Countries, 1978-8/.

TABLE 1
ODA, ABSOLUTE AMOUNTS, 1970-1982
Million U.S. dollars, 1981 prices and exchange rates
Net Disbursement

| 1970 | | 1975 | 1979 | 1980 | 1981 | 1982 |
|---|---|---|---|---|---|---|
| DAC countries | | | | | | 1487 |
| Netherlands | 628 | 870 | 1318 | 1374 | | 573 |
| 1510 | | | | | | 1 128 |
| Norway | 118 | 292 | 500 | 480 | 467 | 439 |
| Sweden | 312 | 858 | 1027 | 884 | 916 | 4 306 |
| Denmark | 172 | 277 | 398 | 412 | 403 | (280 |
| France Once DOM/TOM) 2 735 | | 2 982 | 3 375 | 3 622 | 4 177 | 5) |
| France (exa6 DOM/TOM) | 1749 | 1 828 | / 987 | 2754 | 2 592 | 566 |
| Belgium | 334 | 512 | 556 | 492 | 575 | 3 238 |
| Germany | 1 683 | 2 323 | 3005 | 2 992 | 3 181 | 1932 |
| United Kingdom | 1662 | 1873 | 2733 | 1800 | 2195 | 1103 |
| Canada | 748 | 1253 | 1257 | 1154 | 1189 | 895 |
| Australia | 670 | 853 | 783 | 733 | 650 | 363 |
| Austria | 34 | 117 | 122 | 152 | 314 | 68 |
| New Zealand | 40 | 110 | 74 | 75 | 68 | [illegible] |

| | | | | | | |
|---|---|---|---|---|---|---|
| Total DACC 25635 | 17905 | 21175 | 24128 | 26446 | 28511 | |
| OPEC countries | 1026 | 9540 | 8 239 | 8 855 | 7836 | . |
| of which: | | | | | | .. |
| Saudi Arabia | 446 | 4 214 | 4946 | 5 765 | 5798 | .. |
| Kuwait | 381 | 1446 | 505 | 626 | 685 | .. |
| U.A.E. | | 1599 | 1023 | 879 | 799 | .. |
| Iraq | 10 | 329 | 896 | 804 | 143 | .• |
| Qatar | | 517 | 296 | 275 | 175 | .. |
| Other | 188 | 1434 | 572 | 505 | 236 | • |
| CMEA countries | 2 477 | 1135 | 1 915 | 2088 | 2 129 | .. |
| Total above | 1408 31850 342 | | 000 | 37 389 | 35 00 | |

a Deflated by GNP dilator.

6 Preliminary estimates.

= Individual countries do not add up to total Disfigures for 1970-SO because of the use of a combined total deflator for total DAC.

N £1 G C= U

Note: 1979 to 1981 data include administrative costs of ODA not reported

• Not available

TABLE 4

ODA, PERCENTAGE OF GNP, 1970-1982

Net disbursements

| | 1970• | 197 | 1979s | 1980 | 1981^ | 1982 |
|---|---|---|---|---|---|---|
| DAC countries Netherlands ............ | 0.61 | 0.75 | 0.98 | 1.03 | 1.08 | I.08 |
| Norway ................. | 0.32 | 0.66 | 0.93 | 0.85 | 0.82 | 1.01 |
| Sweden ................. | 0.38 | 0.82 | 0.97 | 0.79 | 0.83 | 1.02 |
| Denmark ................ | 0.38 | 0.58 | 0.76 | 0.74 | 0.73 | 0.77 |
| France: (incl. DOM/TOM) | 0.66 | 0.62 | 0.60 | 0.64 | 0.73 | 0.74 |
| (exci. DOMITOM) | 0.42 | 0.38 | 0.35 | 0.38 | 0.46 | 0.48 |
| Belgium .................. | 0.46 | 0.59 | 0.57 | 0.50 | 0.59 | 0.59 |
| Germany ................ | 0.32 | 0.40 | 0.45 | 0.44 | 0.47 | 0.48 |
| United Kingdom ... | 0.39 | 0.39 | 0.52 | 0.35 | 0.44 | 0.38 |
| Canada .................. | 0.41 | 0.54 | 0.48 | 0.43 | 0.43 | 0.42 |
| Australia ................ | 0.62 | 0.65 | 0.53 | 0.48 | 0.41 | 0.57 |
| Austria .................. | 0.07 | 0.21 | 0.19 | 0.23 | 0.48 | 0.54 |

| | | | | | | |
|---|---|---|---|---|---|---|
| New Zealand .......... | 0.23 | 0.52 | 0.33 | 0.33 | 0.29 | 0.28 |
| Japan ..................... | 0.23 | 0.23 | 0.27 | 0.32 | 0.28 | 0.29 |
| Finland .................. | 0.06 | 0.18 | 0.22 | 0.22 | 0.28 | 0.30 |
| Switzerland ............ | 0.15 | 0.19 | 0.21 | 0.24 | 0.24 | 0.25 |
| United States .......... | 0.32 | 0.27 | 0.20 | 0.27 | 0.20 | 0.27 |
| Italy ....................... | 0.16 | 0.11 | 0.08 | 0.17 | 0.19 | 0.24 |
| Total DAC | 0.34 | 0.36 | 0.35 | 0.38 | 0.35 | 0.39 |
| OPEC countries ..... | 1.18 | 2.92 | 1.88 | 1.74 | 1.46 | |
| o/ which: Saudi Arabia | 5.60 | 7.76 | 6.12 | 5.09 | 4.77 | .. |
| Kuwait .................. | 6.21 | 7.40 | 1.79 | 2.04 | 1.98 | |
| U.A.E ..................... | • • 11.69 5.09 3.38 | | | | 2.88 | |
| Iraq ...................... | 0.13 | 1.63 | 2.53 | 2.12 | 0.37 | |
| Qatar ..................... | • • 15.59 6.03 4.25 | | | | 2.64 | .. |
| Other ..................... | 0.28 | 0.66 | 0.21 | 0.18 | 0.08 | |
| CMEA countries ... | 0.14 | 0.07 | 0.12 | 0.14 | 0.14 | |
| of which: USSR ..................... | 0.15 | 0.07 | 0.13 | 0.15 | 0.15 | |
| GDR ..................... | 0.04 | 0.04 | 0.18 | 0.15 | 0.16 | |
| Eastern Europe, other | 0.12 | 0.08 | 0.09 | 0.11 | 0.10 | |

Excluding administrative costs identified as such.
Shredding administrative costs.
Provisional.
D Ministries costs are included in the U.S. data for all years as shown.
• •- Not available

TABLES
ODA, PERCENTAGE CHANGES, 1970-82
(Average annual percentage changes in real terms)

| 1970/71-1 /81 | 1 5/761980/ 81 | 19 -198/8 76 75 2 |
|---|---|---|
| DAC countries | | |
| Netherlands ---------------------- 8.8 | 9.0 | 6.9 |
| | 8.6 | 2.1 |
| Norway 4.5 | 1.2 | 7.5 |
| Sweden .......... .... 3.4 | 7.9 | 6.5 |
| Denmark......... .... 2.6 | 5.8 | .. |
| France (incl. 4.2 | 2.7. | 5.4 |
| DOM/TOM) ... 5,8 | 6.6 | 8,7 |
| Belgium .......................... 1.0 | 1.3 | 0.1 |
| Germany ,........................ 4.2 | -0.3 | -0.8 |
| United Kingdom ............ 0.6 | -0.3 | 6.3 |
| Canada ........................... 21,0 | 19.9 | 26.7 |
| Australia ......................... 5.6 | -6.6 | -4.6 |
| Austria ,,,,,,,,................ 7.4 | 12.3 | 11.7 |
| New Zealand ------------- 14.7 | 11.2 | 15.9 |
| Japan .............................. 5.7 | 6.3 | 7.3 |
| Finland ............................ 06 | I.2 | 1.1 |
| 4.6 | 14.6 | 18.0 |

Switzerland ......................
United States, .................
Italy .................................
Total DAC
OPEC countries ----------
aI which:
Saudi Arabia .................
Kuwait ---------------------
Iraq .................................
Qatar ..............................
Other ..............................
CMEA countries --------
a( n hieh:
USSR .............................
GDR ...............................
Eastern Europe, other ...
Total above ....................
•• - Not available.

TASLE6
CONCESSIONAL ASSISTANCE BY OPEC MEMBERS, 1970-1911
Net Million U.S.

| | 1970 | 1971 | 1972 | 1973 | 1974 | 1975 | 1976 | 1977 | 1971 | 1979 | 1980 | 1911 | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| I. Gulf States | 148 | 108 | 153 | 356 | 631 | 946 | 532 | 1 309 | 991 | 477 | 645 | 685 | |
| Kuwait ..................... | | | | | | | | | | | | | |
| Qatar ......................... | | - | | 94 | 185 | 338 | 195 | 194 | 109 | 280 | 284 | I75 | |
| SaudiArabia | 173 | 214 | 366 | 1118 | 2153 | 2756 | 3033 | 3138 | 5507 | 4674 | 5944 | 5798 | |
| UAE | -- | 50 | 74 | 289 | 510 | 1016 | 1021 | 1060 | 891 | 967 | 906 | 799 | |
| Total .......................... | 321 | 372 | 593 | 1857 | 3479 | 5086 | 4781 | 5701 | 7498 | 6398 | 7779 | 7457 | |
| II. Other Arab Donors | - | - | - | 25 | 47 | 41 | 54 | 47 | 44 | 272 | 65 | 65 | |
| Algeria | | | | | | | | | | | | | |
| Iraq ............................. | 4 | 8 | 11 | II | 423 | 215 | 231 | 61 | 173 | 847 | 829 | 143 | |
| Libya | 68 | 64 | 69' | 215 | 147 | 259 | 44 | 113 | 146 | 105 | 282 | 105 | 0 |
| Total | 72 | 72 | 80 | 25! | 617 | 515 | 379 | 221 | 363 | 1224 | 176 | 313 | S |
| | | | | | | | | | | | 7 | -150 | t |
| 177. Non-Arab Donors | | | | | | | | | | | | | |
| Iran ............................. | 4 | | 3 | 2 | 408 | 597 | 753 | 221 | 218 | 25 | | | |
| Nigeria ...................... | - | - | - | 5 | 15 | 14 | 83 | 64 | 38 | 30 | 42 | 149 | C7 |
| Venetuela | I | | 28 | 1S | 60 | 31 | 108 | 56 | I15 | 109 | 125 | 67 | |
| Total .......................... | 5 | 8 | 31 | 25 | 483 | 638 | 944 | 341 | 431 | 164 | 174 | 66 | p |
| Overall Total ............. | 398 | 452 | 700 | 2 113 | 4579 | 6239 | 6 104 | 6263 | 8 292 | 7 786 | 9124 | 7876 | ep |
| Total in 1981 constant | 1026 | 1097 | 1537 | 4 158 | $076 | 9 540 | 9 056 | 8603 | 9 895 | 8 239 | 8 855 | 7836 | |

ODA APPROPRIATIONS | TABLE 7 IN CENTR | GOV | BUDGETS

ODA as % of Central | Annual nominal increau(%)s

| Countries | 797 | 7975 | 1975 | 1975 | ODA | Govl |
|---|---|---|---|---|---|---|
| Australia ......... | 5 | 1.5 | 1.6 | 1.6 | budget | Central Govt. _ |
| Austria .......... | .6 | 0.3 | 0.4 | 0.4 | 12.1' | budget |
| Belgium .. | 0.4 | 1.6 | L3 | (1.4) | 0.9 | 13.9c |
| Canada | 1,9 | 2.0 | 2.2 | 23 | 19.4 | 9.9 |
| Denmark ......... | 26 | 2.0 | 1.9 | • • | 17.6 | (7.8) |
| Finland ............ | 2.0 | 0.8 | 1.0 | 1.1 | 8.2c | 11.5 |
| France | 0.7 | 3.0 | 3.0 | • • | 31.0 | 13.90 |
| Germany (BMZ) | 3.7 | 2.5 | 2.5 | 2.5 | 24.7d | 16.0 |
| Italy | 2.2 | 0.6 | 0.7 | 0.8 | 4.7 | 27.6 |
| Japan ............... | • • | 2.2 | 2.1 | (2.2) | 50.0 | 3.2 |
| Netherlands | 17 | 3.0 | 2.8 | • | 11.4 | I1.1 |
| New Zealand , .. | 2.2 | 0.6 | 0.5 | 0,[4] | 7.8 | 22.7° |
| Norway ... | 1,5 | 2.6 | 2.8 | 3.0 | 8.5c | 17.7 |
| Sweden .. | 2.3 | 2.5 | 2.5 | 2.6 | 27.0 | 5.9 |
| Switzerland ... | 2.9 | 2.4 | 2.6 | 2.6 | 8.9 | • |
| United Kingdom | 1.9 | 1.5 | 1.3 | 1.2 | 5.8 | 14.9c |
| United States ... | | 12 | 1.0 | 1.0 | 9.9c | 4.5 |

a) Figures refer toothe years year fiscal rwis beginnin indic
C) 1981 or 1981g2.
d) DOM-TOM

| GROWTH OF MULTILATERAL Average | annual | TABLE percent age | S changes | CONTRIBUTIONS in | AND TOTAL 1951 dollars | ODA |
|---|---|---|---|---|---|---|
| 1970 to 1975i 1976 | | .......... | | | Multilater | Total |
| 1975/ 1976 to 1980) | | | | | 13.0 | 4,3 |
| 1981 | | | | | 5.6 | 4,3 |
| 1978 to 1980/ 1981 | | | | | 1.1 | 3.2 |

TABLE 9
LOAN AND GRANT DISBURSEMENTS BY MULTILATERAL AGENCIES
Net Disbursements – Million U.S. dollars

| Agencies | | Coneessfona | | | | | | Nol,-toJIcessional flows | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | 1970 | 197 | 1977 | 1978 | 1980 | 1981 | 1970 | 197 | 1977 | | 1979 | 198 | 198 | |
| IHRD2 .......................... | net | - | I6 | 39 | 76 | 107 | 88 | 5118 | 172 | 1833 | | 284 | 315 | .1 | |
| IDA ............................... | gross | 163 | 16 | 107 | | 107 | 88 | 810 | 4 | 2104 | | 6 | 6 | W3 | |
| (FC ................................ | net | Ih3 | 131 | 39 | 76 | 1543 | 1918 | - | 227 | 2 | 501 | 378 | 431 | 501 | |
| IDO ............................... | gross | 224 | 0 | 107 | | 1584 | 1963 | - | 9 | 2991 | | 6 | 0 | 5 | |
| | net | | 132 | 1132 | I(7 | - | 438 | 68 | 193 | 98 | 58 | | 295 | - | |
| ofnhich: ......................... | gross | 245 | 10 | 392 | 433 | 486 | .. | ISO | 398 | 552 | 360 | 613 | 813 | .. | S |
| African D.H. and Fund | grant | I | 501 | 461 | | 96 | 91 | 2 | 44 | _ | | 92 | 97 | _ | p |
| Asian D.H ..................... | s | I | 512 | 26 | 39 | 96 | 93 | 2 | 51 | 66 | 83 | 108 | Ill | 70 | ~ |
| u(mhlch: ....................... | net | 210 | 39E | 55 | | 149 | .. | I5 | 232 | 73 | 93 | 278 | 378 | 99 | >; |
| Car ................................ | gross | 210 | 125 | 26 | 44 | 159 | .. | 16 | 263 | 225 | 229 | 361 | 429 | .. | ~ |
| EEC Flab | net | 174 | 2 | 57 | | 43 | .. | - | 6 | 272 | 294 | 7 | 13 | .. | a |
| o/ Whlclc ...................... | gross | 498 | 419 | 89 | 161 | .101 | 1470 | II | 58 | II- | | 162 | 257 | .. | n |

| | | |
|---|---|---|
| IMFTrusIFund .............<br>IFAD ............................<br>United Naoonx<br>Arab OPEC Funds ....<br>of o'hh'h:<br>Tonal | 434<br>75<br>..<br>1119 386 4832 60777759 18()<br>6 7 6202 7936 01 | -<br>688 254 2690 4159 484 ..<br>I0( 2 3087 S7() 9 .. |

nll:rludlny(I ra'e(nycd Il-C 6) n¢tMJdclloeludin Sole:

| | PRIVATE | | VOLUNTARY | TABLE II | CONTRIBUTIONS, | 1970-1981 | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | 1981 | | | | Net outflows from NCOsa | | | | | | |
| Countries | | | | | | $ million | | | | | |
| Norway .................. | of | 8 per | 1970 | 197$ | 1976 | 1977 | 1978 | 1979 | 1980 | 1981 | 4, |
| Switzerland ............. | As | capid | 3.9 | 10.6 | 19.1 | 23.5 | 25.9 | 30.0 | 33.0 | 36.0 | c |
| Netherlands ............. | CNP | 9 | 10.9 | 32.1 | 34.4 | 34.4 | 48.6 | 51.3 | 63.2 | (60.0) | s |
| Germany ................. | 0.06 | 9 | 5.2 | 23.5 | 30.4 | 42.7 | 55.5 | 65.2 | 78.7 | 85.2 | p, |
| Sweden .................... | 0.06 | 6 | 77.8 | 205.0 | 204.6 | 225.0 | 284.0 | 389.4 | 420.7 | 371.1 | 0 |
| Belgium .................. | 0.06 | 6 | 25.2 | 38.8 | 43.4 | 43.5 | 44.3 | 49.0 | 59.0 | 59.0 | C |
| Canada ................... | 0.05 | 7 | 14.8 | 20.0 | 22.5 | 27.2 | 31.5 | 41.0 | 45.0 | 37.3 | _. |
| United States ... | 0.05 | 4 | 51.6 | 66.5 | 106.0 | 103.0 | 87.1 | 96.0 | 102.0 | 103.0 | e |
| Austria .................... | 0.04 | 4 | 598.0 | 804.0 | 789.0 | 840.0 | 931.0 | 1 029.0 | 1 301.0 | 1 018.0 | |
| Finland .................. | 0.04 | 4 | 3.6 | 11.1 | 11.0 | 10.8 | 14.6 | 16.1 | 23.5 | 20.2 | |
| New Zealand .......... | 0.03 | 3 | 0.8 | 2.2 | 4.5 | 49 | 6.2 | 10.1 | 15.5 | 134 | |
| Australia ................. | 0.03 | 3 | 1.4 | 6.4 | 5.5 | 5.6 | 5.9 | 9.6 | 6.8 | 6.8 | |
| Denmark | 0.03 | 2 | 15.7 | 33.8 | 37.2 | 35.9 | 38.3 | 49.2 | 39.7 | 35.8 | |
| United Kingdom ... | 0.03 | 2 | 3.0 | 6.2 | 5.6 | 6.6 | 8.1 | 10.4 | 12.9 | 10.0 | |
| France ..................... | 0.02 | 2 | 33.6 | 57.8 | 52.4 | 50.0 | 55.7 | 107.7 | 120.2 | 101.4 | |
| Italy ........................ | 0.02 | I | 6.3 | 15 2 | 15.1 | 16.3 | 19.9 | 23.5 | 35.7 | 32.0 | |
| Japan ....................... | 0.02 | 3 | 5.0 | 3.0 | 0.2 | 1.1 | 0.3 | 0.2 | 3.1 | 1.2 | |
| Total DAC countries | 0.01 | | 2.9 | 10.0 | 16.2 | 18.3 | 18.9 | 19.0 | 26.4 | 27.3 | |
| a) Nongovernmental organizations. | x<br>x | | 859.7 | 1346.2 | 1397.1 | 1488.8 | 1675.7 | 1996.7 | 2386.4 | (2017.7) | |

TABLE 12
ODA PER CAPITA OF
THIRTY LARGEST DIM RECIPIENTS, 1980

| | | 1980 |
|---|---|---|
| Country | GNP Per Capita | ODA Per Capita* |
| Kampuchea | n a. | 40.8 |
| Bangladesh | 120 | 14.0 |
| Somalia | nab. | III.8 |
| | | 9.3 |

| | |
|---|---|
| Burma | 180 |
| Mali | 190 |
| Zaire | 220 |
| India | 220 |
| Tanzania | 240 |
| Sri Lanka | 270 |
| Pakistan | 300 |
| Indonesia | 420 |
| Kenya | 420 |
| Senegal | 450 |
| Yemen Arab Republic | 460 |
| Sudan | 470 |
| Zambia | 560 |
| Egypt | 580 |
| Thailand | 670 |
| Cameroon | 670 |
| Philippines | 720 |
| Papua New Guinea | 780 |
| Morocco | 860 |
| Tunisia | 1310 |
| Syria | 1340 |
| Jordan | 1420 |
| Lebanon | na. |
| Turkey | 1460 |
| Reunion | 3830 |

Net disbursements of ODA from DAC and OPEC members, multilateral development institutions

# PART IV
# IMPLICATIONS

## FOR REGIONS AND COUNTRIES

"It is very disheartening for countries to sacrifice vital imports—medicine, spare parts, industrial raw materialsin order to meet the service payments on external debt, particularly when these payments are much higher than originally anticipated, due to the increase in international interest rates."

Richard D. Fletcher

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# CHAPTER 13
## An Overview*
**Khadija Haq**

The current international financial crisis is truly global, reaching every country, developed and developing, in its various symptoms and effects. The natural polarity by which the crisis is viewed is a North-South polarity, setting the interests of creditors and debtors against each other. However, in truth, the global difficulties are many-faceted, with distinctive implications for the U.S., for Japan, for Europe, for the poorest countries, for Latin America, Asia, Africa, and the Gulf countries. Some of the problems can be generalized. The oil shocks, high interest rates, trade deterioration, and shrinking liquidity are developments affecting all parties. Some of the needed responses too, are general. But a full

understanding of the world situation must include the comprehension of the distinctive difficulties, needs, and prospects of each of the major regions affected by the crisis.

Some of the special problems encountered by the low-income countries in the current crisis have been covered in Part III. Chapters 16 and 17 of this section supplement that analysis with a discussion of the particular troubles facing Africa, especially sub-Saharan Africa. These discussions emphasize that, although the low-income countries may not be the biggest debtors, and although they are not the focus of most of the ongoing debate and negotiation, their condition is perhaps the most acutely imperiled by the recession and crisis.

The low-income countries, most of the poorest of which are in Africa, have little room for adjustment and little power of response to the present constraints in external finance and world liquidity. Despite their limited access to commercial loans in the past, many among the poor countries find themselves in debt-servicing difficulties. With the unexpected steep rise of interest rates in the early 'SOs, present debt service obligations have far outstripped the LDCs' ability to pay. And, perhaps even more than for the big debtors, the poor countries' access to new flows of finance for debt repayment much less development-is extremely limited, and for some nonexistent. These countries, with severe needs in the basic areas of health, education, nutrition, and housing, have little prospect of external resources for resumption of their now stagnant development. Concessional finance, which declined relative to commercial loans during the '70s, is more constrained than ever in the present atmosphere of recession and crisis.

In addition to these liquidity constraints, the trade position of the poor countries has deteriorated markedly in the early '80s. Without sufficient access to Northern markets, because of low demand and rising protectionism, the exports of the LDCs have declined, worsening their balance-of-payments positions and their debt servicing capacity, and creating an untenable situation in many of their economies. These terms-of-trade difficulties threaten the poor countries with an uncontrollable slide into deeper poverty. The situation is greatly aggravated by the falling prices of commodities, the LDCs' predominant exports.

The most striking portrait of the current devastation for low-income countries can be seen in the African continent. Here, all the adverse movements in the world economy have taken their greatest toll. Plunging commodity prices affect over 70 per cent of African exports-largely agricultural and mineral-and Africa as a whole has suffered greater drops in the purchasing power of its exports than any other region. Declining demand in the North for Africa's products is affecting production and employment in these very poor countries, with destabilizing effects on social and political conditions. Per capita income is steadily declining.

With high balance-of-payments deficits, African countries have been forced to resort to short-term, high-interest borrowing, for lack of other resources to finance these deficits. The debt-service/GNP ratio of the continent rose 28 per cent in 1982, a very undesirable situation indeed. Twenty-three African countries are now negotiating adjustment programs with the IMF, to alleviate the current pressures, but despite stringent domestic economic measures, few of the countries are able to meet the IMF's adjustment targets. The African countries are caught in a vicious trap of rising needs and rising obligations. Relief from these conditions is imperative.

The problems of the biggest debtors-especially the middle-income countries of Latin America-are, similarly, problems of liquidity, debt service requirements, and worsened terms of trade. However, these countries enjoy two advantages over the LDCs in the current crisis: more developed and flexible economies, and more economic weight in the bargaining with creditors and with the North generally. Of course, there can be no question that the difficulties and strains facing them are of enormous proportions, and that satisfactory solutions have yet to be formulated.

In 1982, debt service requirements on $300 billion worth of debt absorbed over half the value of Latin America's exports. Much of this burden is concentrated in four

countries, where the situation has reached the brink of catastrophe and has necessitated extraordinary efforts of renegotiation and adjustment. Much of the adjustment has involved a reduction in imports into the region-imports needed for domestic productive activity and for social development. As a result, Latin American GDP in 1982 and '83 declined for the first time since World War II. Furthermore, new financial flows to the region have slowed to a trickle, creating a situation where these "developing" countries are in fact net exporters of capital.

The Latin American circumstances and possible remedies are discussed in Chapter 14.

One middle-income developing country has undergone a debt restructuring and internal adjustment process that can perhaps serve as a model for other debt-troubled economies. Chapter IS details the successful effort made by Turkey in 1980 to extricate itself from a serious financial crisis. After repeated but fruitless efforts at debt restructuring. Turkey implemented a stringent and carefully managed program of internal adjustments and then undertook a final round of negotiations with creditors. The terms of debt repayment reached in this last round give Turkey room enough for recovery and a resumption of growth, thus enabling a sustained, long-term capacity for debt servicing and for development. Turkey has been successful in meeting its schedule of payments and foresees no difficulty in continuing to do so.

Some regions of the developing world are, for various reasons, less affected by the international debt crisis, though none go unscathed by the shrinking of liquidity and decline of trade. Some Asian countries-Korea, Taiwan, Malaysia, the Philippines and othershave avoided severe debt problems, partly through internal financial and monetary policies which have kept their economies relatively free of distortions in interest and exchange rates, prices and so on. And the Gulf countries, although they are undergoing gradual adjustments to the passing of the era of huge oil surpluses, are not plagued by external debts.

The situation of the Arab Gulf countries nevertheless has important implications for the world financial scene. The surpluses of the Gulf region in the '70s provided the wellspring for the rapid expansion of commercial lending to developing countries. Since the oil "shock" of 1982 brought a decline in oil prices, and since the sudden boom of the '70s has passed, the financial flow from the Gulf has moderated. It is unlikely that the vast surpluses and the surge in commercial resources will recur in the foreseeable future. Therefore, the world, like the Gulf countries themselves, must adjust itself to the present conditions of ebbing international liquidity. The circumstances of the Gulf area in the current world economy are elaborated in Chapter 18.

Finally, the crisis has implications not only for debtor countries but also for creditor countries. in fact, it can be argued that the main source of the current debt servicing difficulties is the policies of creditor country governments, especially in the U.S. A huge U.S. budget deficit, absorbing a substantial proportion of domestic savings, and making the U.S. a net importer of capital, is the main force driving interest rates to their present high levels. And trade imbalances are spurring a rising trend of protectionism among the developed countries, which hinders world recovery and hampers the adjustment efforts of the developing world. Thus, the solution of the current crisis will require adjustment and alignment of creditor country policies.

It should be remembered that, besides the North-South debate in ongoing renegotiations, there is perhaps a more powerful West-West debate on recovery, among the U.S., Japan, and Europe, which has very significant implications for the developing world. Perhaps when these Northern protagonists understand that the debt crisis of developing countries is aborting and wilt continue to abort all efforts at recovery in their own economies, the explicit convergence of North South interests will finally stimulate the cooperation needed for a lasting solution.

# CHAPTER 14
# Implications of the Current Crisis For Latin America*
Richard Fletcher

## I. INTRODUCTION

External indebtedness has become a serious obstacle to Latin America's economic development. Total external indebtedness of the region is now more than $300 billion, most of which is concentrated among four borrowers-Brazil at $90 billion, Mexico at $80 billion, Argentina at $30 billion, and Venezuela at $28 billion. The debt crisis results from the high debt service burden which in 1982 absorbed 56 per cent of the value of Latin America's exports. Debt service obligations preempt foreign exchange resources, so that Latin American nations are obliged to cut back on imports needed to maintain economic growth and social development.

The results have been dramatic. In 1982, the region suffered a decline in GDP of approximately 1 per cent, the first decline since World War II. The forecast for 1983 is that the situation will be even worse, with nearly every country showing negative growth. Statistics
c are not yet available to show the effect of the crisis on social variables such as health and nutrition. However, one indicator which we do have, the rate of urban unemployment, shows rapid increases in most cities of Latin America.

Even more dramatic than the effects of the debt crisis has been its unexpectedness. Up until 1980, there was no crisis. On the contrary, external debt was seen not as a problem inhibiting Latin American development, but rather as a part of the solution to underdevelopment.

## II. BACKGROUND TO THE DEBT CRISIS

The 1960s- The Good Old Days. During the late 1960s and early 1970s Latin America's rate of investment and of GDP growth exceeded the levels that could be sustained purely through the use of domestic resources. As a result, the region experienced a chronic "resource gap" (or deficit in the balance of trade and non-factor he views presented are those of the author and do not necessarily reflect those of the Inter-American Development Bank. services) and was a net importer of capital.

It should be noted that in principle there is nothing wrong in less developed countries (LDCs) being net capital importers. In fact, it is in the nature of "underdevelopment" that for a time a country will need resources from outside. The opposite situation, that of LDCs exporting capital-in other words, poor countries transferring real resources to rich countries-is inconsistent both with equity and with the objective of maximizing the growth of the world economy as a whole. On the other hand, it is obvious that an LDC cannot expect to sustain resource gaps which are excessively large for any length of time. This is because the resource gap must be financed, and the resulting capital inflow, whether in the form of debt or direct investment, will create future service obligations. Prudent management, therefore, requires first that the resource gap be kept within reasonable limits and second, that capital inflows be used to expand production and exports so as to create capacity to meet future service obligations. This was the case in Latin America in the 1960s. During that period there was a combination of favorable factors:

1. The resource gap was small, averaging 1 per cent of GDP.
2. Capital inflows to finance the resource gap consisted mainly of
Investment finance-in the form of direct equity, project loans
from multilateral banks, and suppliers' credits on capital goods. 3. Interest rates on external indebtedness were low, averaging less than 2 per cent in real terms.
4. Production and especially exports grew rapidly, so debt service ratios were manageable.
As a result of the combination of the above factors, confidence in Latin America's creditworthiness steadily improved, and commercial bankers became increasingly willing to extend loans to the region.
The /970s-Recycling Oil Surpluses. After 1973, the favorable combination began to unravel. Oil prices rose in 1973 (and again in 1979), producing sudden increases in import costs for most countries of the region, leading to substantial expansion of financing needs.
By 1978, Latin America had made substantial adjustment to the new situation, in that the resource gap which in 1975 had doubled to 2 per cent of GDP was again reduced to only 1 per cent. But debt service had now become a problem, and because of interest payments, the current account deficit had risen from a mere 2 per cent to
5 per cent of GDP. External debt accumulated rapidly, from $42 billion in 1973 to $207 billion in 1980. Debt service obligations increased even more rapidly, from $4 billion to $27 billion in the same period and to $38 billion in 1982, And since the increase in debt service was more rapid than the growth of exports-which rose from $25 billion to $92 billion between 1973 and 1980-the debt service ratio soared from 14 per cent to 30 per cent.
Despite the deterioration in the balance of payments and the debt profile, there was still no debt crisis during that period because: I. interest rates continued to be low-in fact, they were negative
In real terms for part of 1973-80, which encouraged imprudent?
Borrowing;
2. Export prices were high; and
3. most important of all, private commercial banks, whose confidence was stimulated by the high profits being made, continued to extend new credits to the major Latin American debtors in amounts which exceeded the sum of debt service and deficits of trade.

**The 19805-The Onset of the Crisis. After 1980, the combination**

Of favorable factors completely broke down:
1. Interest rates rose rapidly in nominal terms and even more rapidly in real terms.
2. The prices of Latin America's main export commodities sugar, coffee, copper, bauxite-fell, causing a decline in the terms of trade of more than 10 per cent between 1980 and 1982.
3. Confidence of commercial bankers was abruptly ended. Instead
Of being willing to extend new loans, bankers now wished to reduce their exposure.
It is important to emphasize that these changes were not the result of economic mismanagement by the Latin American nations. The decline in Latin America's terms of trade resulted from the recession in the industrialized countries, and the increase in interest rates resulted from the combination in the U.S.A. of large fiscal deficits with restrictive monetary policy.
Mismanagement did play a part, in that excessive external borrowing during the 1970s reduced Latin America's capacity to cope with the crisis of the 1980s. But it is an interesting paradox that it was precisely when inappropriate policies were being followed that Latin America's creditworthiness was highest and that bankers were most eager to lend, in other words, the international commercial banks gave financial support to the very mismanagement which they now criticize.

## III. SOLUTIONS TO THE CRISIS

We have seen that the current Latin American debt crisis has resulted from high interest rates, a decline in commodity prices, and loss of confidence in the region's creditworthiness. None of these factors are due to any structural deterioration in Latin America's productive capacity. Thus it is fair to say that the crisis does not reflect a lack of solvency, but rather a lack of liquidity. In other words, Latin America's productive capacity is such that, given "normal" levels of interest rates, export prices and bankers' confidence, the region would be able to meet its debt service obligations as well as pay for its necessary imports.

Therefore, in seeking a solution to the crisis, we should seek a return to normalcy-restoration of growth in world production and trade and a decline in interest rates. Restoration of growth has now started in the United States. But we do not know if and when this will produce a recovery of world trade and hence commodity prices, nor do we know whether the recovery will be long-lasting. In addition, there is no sign that interest rates will come down in the near future.

Uncertainty about the speed and duration of recovery is a problem, because if the present liquidity crisis is not solved in the near future it could easily become a more serious crisis of solvency. Latin America is now being starved of necessary imports in order to enable it to meet its debt service obligations. Inability to purchase necessary imports is forcing cutbacks in investment programs, maintenance and replacement of productive equipment, and the provision of social services. These cutbacks are beginning to have a negative effect on Latin America's productive capacity.

It is clear, therefore, that the liquidity crisis must be solved soon if we are to avoid the onset of a solvency crisis. But it is also important to realize that some of the so-called solutions to the liquidity crisis are non-solutions, in that they will themselves produce solvency crises. Three of these non-solutions-"debt repudiation," "extreme adjustment," and "unlimited new financing" warrant our consideration.

**L Debt repudiation**. It is very disheartening for countries to sacrifice vital imports-medicine, spare parts, industrial raw materials-in order to meet the service payments on external debt, particularly when these payments are much higher than originally anticipated, due to the increase in international interest rates. In these circumstances, it is not surprising that debtor nations are tempted to repudiate debts, i.e., simply refuse to pay. What is surprising, however, is that during the last two years of debt crisis, not a single Latin American nation has chosen this option. There are good reasons for this:

First, a nation that repudiates its debt obligations will cut itself off from future capital inflows and will have to pay for imports purely from its export earnings. This is undesirable since, as we saw earlier, the appropriate strategy for a LDC is to be a net importer of capital at prudent levels.

Second, nations that repudiate are likely to suffer retaliation from disappointed creditors in the form of action against their assets abroad and against their trade. Thus, its exports will be adversely affected.

The net result of the above is that repudiation will lead to an even lower level of foreign exchange being available for necessary imports. This is the fundamental, pragmatic reason why debtor nations continue to reject this option.

2. Extreme adjustment. In this scenario, creditors insist that debt obligations be paid in full while reducing new loans (to zero if possible). Consequently, the debtor nation must "adjust": increase exports and/or reduce imports to earn a trade surplus equivalent to debt service. This non-solution also suffers from a number of flaws:

First, there is a fallacy of composition. Whereas it is possible for a few nations to increase exports and reduce imports, it is impossible for many nations to do so simultaneously. Second. the world recession makes it very difficult for Latin America to increase its exports to industrialized countries significantly at the present time. Third, there is a limit to the extent to which imports can be decreased without having negative effects on production and exports. Curtailment of imports affects producer inputs (including capital goods) as well as consumption. Moreover, compression of consumption levels can lead to social and political instability, which ultimately causes a decline in output.
Thus adjustment carried to extreme lengths can be selfdefeating. It can lead to a decline in foreign exchange earnings, thereby reducing the ability to service debt and increasing the risk of involuntary default. Finally, it is worth mentioning that the "extreme adjustment" option would create the peculiar situation of a net outflow of finance from debtor LDCs to the creditor industrialized countries. This is precisely what has happened since 1982.
3. Unlimited new financing. In this option, debtor nations do not adjust, i.e., do not reduce their trade deficits, but finance them together with debt service by means of inflows of new capital. This in fact was the strategy followed throughout the late 1970s and early 1980s, which reached a peak in 1981 when net new financing to Latin America reached $40 billion. This option is no longer sustainable.
First, commercial banks, which were the main source of new finance in the last few years, are unwilling to continue lending at these levels. There have been suggestions that other private sources (e.g., pension funds, insurance companies) could become involved, but this will not occur in the present climate of uncertainty about Latin America's creditworthiness.
Second, it is not desirable that Latin America continue to receive large net inflows of finance on commercial terms. Debt service ratios are already at unsupportable levels, and given the high rates of interest and the poor prospects for exports, new indebtedness will simply build up the debt service burden, leading to a second wave of the debt crisis within two or three years. In this connection, it is important to remember the rule of thumb which William Cline attributes to Mario Simons: borrowing will get you out of trouble only if exports grow faster than the nominal rate of interest. These conditions just do not exist at this time.

## IV. A VIABLE SOLUTION

I have argued that the Latin American debt crisis is a liquidity crisis resulting from the peculiar combination of extraordinarily high real rates of interest and low terms of trade for Latin America's exports. The situation has been exacerbated by the reversal of confidence in the area's creditworthiness. I also warned that a return to normal conditions may not occur before the liquidity crisis becomes a solvency crisis, i.e., begins to affect the region's productive capacity. Finally, I pointed out those three extreme types of solution to the crisis-"debt repudiation." "Extreme adjustment" and "unlimited new financing"-would in fact be non-solutions and could make things worse.
But this does not mean that the situation is hopeless. In fact, examination of the non-solutions does suggest that there is a combination of measures which might be adequate. This combination involves the following:
1. Debtor adjustment. Latin America must bring its balance of payments in line with a sustainable long-term pattern. This means it should avoid huge current account deficits which cannot be financed. But equally, it is unrealistic to expect Latin America to have a trade surplus, that is, to export capital to the industrialized world.
In my opinion, a reasonable target to aim at would be a trade deficit of approximately I per cent of GDP-the level which was sustained in the "good old days" of the 1960s. At today's level of regional GDP (approximately US

$600 billion) this would imply a deficit in trade of $6 billion, as compared with the $11 billion deficit of 1981.

2. Creditor adjustment. Current levels of debt service must be reduced. Interest rates are abnormally high by historical standards and should be brought down to realistic levels on existing debt. Again, I think that the "good old days" provide us with a reasonable target to aim at, namely, real rates of interest of 2 per cent per year. If we assume for the sake of illustration that Latin America exists external debt of $300 billion carried an average real rate of 2 per cent interest (with indexation of the principal); then the burden of interest payments would fall from some $30 billion in 1982 to approximately $6 billion.

This drastic reduction would clearly provide great relief to debtor nations, but what would be the effect on creditors?

First. It would not affect the capital or reserves of banks, since the principal value of loans would not be affected. Indeed. By reducing (or removing) the risk of default it should enhance balance sheets.

Second, it would not substantially affect the net flow of cash to/from creditors since gross new flows would be correspondingly reduced.

Third, it would significantly affect creditors' earnings-by almost $30 billion. This amount is not large compared with the total gross interest earned by commercial banks in industrialized countries which is hundreds of billions of dollars.' but it is more than could be absorbed simply by adjusting profit spreads. Some of the adjustment would therefore have to be passed on to depositors. In my opinion this could be done without destroying the international monetary system as a whole or even the few highly exposed banks. The supply of deposit is elastic, but not infinitely so; in other words, the banking system is a price setter and not merely a price taker of interest rates and adjustments of 2 or 3 per cent can be absorbed. In any event. I question whether it is equitable, or even practical, to expect citizens in debtor nations to "adjust" by accepting real wage cuts of 20 to 30 per cent, while denying that depositors of funds in creditor countries could accept 2 to 3 per cent less in interest rates.

3. New financing requirements. The combination of debtor and creditor adjustments mentioned above would substantially alter the balance of payments for the Latin American region and would produce a pattern that, in my opinion, is sustainable, as compared with unsustainable patterns in 1981-83. One important implication is that the net financing requirement (the current account deficit) would decline from over $30 billion to a mere $12 billion. This is an amount which could be maintained. Equally important, it could be provided entirely from official and multilateral sources and suppliers' credits. For example:

'In the Federal Reserve Bulletin of July 1983. Mrs. Barbara Opper mentions (p. 501) that total interest earned by U.S. commerical banks in 1982 was $235 billion.

IMF $5 billion IBRD, 1DB $4 billion Ex-Im Banks $2 billion Suppliers' Credits $1 billion This pattern of new financing would have several advantages:

First, it would be oriented toward projects which expand productive capacity, or would carry conditionality and would not finance wasteful consumption, as occurred with some of the non-project lending of the 1970s. Second, official financing would be more stable than private financing, both in terms of interest rates and of new flows.

Thirdly, the fact that no new private financing would be required would itself help to restore confidence in Latin America's creditworthiness. This is because bankers are like people who lend umbrellas-they are eager to lend when they believe you won't need it.

The final issue is whether a viable solution as proposed can be arrived at. Clearly there is little difficulty in achieving debtor adjustment. This is taking place already, country by country, under the auspices of the IMF. The new financing requirements suggested are also feasible, given current levels of activity of the IMF, etc. Problems arise in the case of creditor adjustment. Bankers will be extremely reluctant to accept a reduction of interest rates on existing debt,

even though they do recognize that current rates are extraordinarily high by historic standards. To achieve the result, therefore, there would have to be concerted actions on the part of debtor nations to establish a framework within which country-by-country renegotiations could take place.

## V. CONCLUSIONS

The high burden of debt service of the Latin American countries is impeding economic development since the region is unable to meet its debt obligations and also purchase the minimal level of imports needed for growth and social stability. Debt has therefore become an obstacle to development in the 1980s. This was not the case in the 1960s, when external capital fueled growth by supplementing domestic resources and by increasing the region's capacity to import. Resumption of viable development in Latin America will be assisted by the world recovery which is now under way. But recovery will not occur soon enough and may not be sustained. There also has to be a solution of the debt crisis. This in turn requires the following:

a) Adjustment on the part of debtor nations. The net financing requirement (the resource gap) of the region must be brought down to sustainable levels such as those experienced in the 1960s (I per cent of GDp). However, adjustment should not be carried to the point where underdeveloped countries are re required to earn a resource surplus and export capital to the developed world.

b) Adjustment on the part of creditors. The real level of interest rates on existing debt is far too high. Insistence on payment of these rates will starve debtor nations of needed imports, weaken their productive capacity and ultimately force them into default. A number of methods of restructuring the debt have been proposed and should be explored seriously. None of these methods will work, however, unless rafts of interest are considerably reduced, say to 2 per cent in real terms, the level that held until the early 1970s. Such a reduction could be undertaken without damaging the international monetary system or individual private banks.

e) Expansion of official lending. If the existing stock of debt were renegotiated at reasonable real rates of interest, the debt servicing burden of Latin America would be considerably reduced. The financing requirements of the 1980s could then be provided by international agencies, official aid and export financing. Such lending would also have a more powerful developmental impact than did the "recycling" of petrodollars in the 1970s.

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# CHAPTER 15
# Debt Rescheduling: The Turkish Experience

**Turgut Ozal**

## BACKGROUND

The Turkish economy experienced severe difficulties between 1976 and 1980. Due to current account deficits, Turkish external debt increased at an annual average rate of 37 per cent in this period. In 1979, exchange and trade restrictions replaced external financing to contain current account deficits, and debt growth slowed to 8 per cent. Before 1979, the maturity structure of the debt was much deteriorated, because of heavy recourse to short-term credits in the form of

convertible Turkish lira deposits (Colds) and commercial arrears.
The sharply increased dependence on external financing without corresponding economic growth increased the ratio of external debt to GNP from 20 per cent in 1976 to 33 per cent in 1980. Debt service problems after 1977 led to large arrears with commercial banks and bilateral official lenders. Several rescheduling were completed. Despite these, debt service was still a difficult task at the beginning of 1980.
On January 24, 1980, a comprehensive economic recovery and stabilization program was started. For this program to be successful, debt service obligations had to be reduced to manageable levels. And rescheduling with reasonable terms was of primary importance to ensure the long-term success of the stabilization program.
Before going into the details of the rescheduling experience, 1 would like to comment on specific problems facing a country undergoing severe economic difficulties, from the point of view of the Turkish experience. When a country reaches a balance-of-payments crisis, the reaction of international financial institutions is always very harsh and excessive. Immediately, all credit lines are withdrawn and coverage for letters of credit is raised to one hundred per cent, making an already critical situation worse. Export insurance systems stop working, and imports are affected severely. Restricted imports affect exports that use imported raw materials or parts in their manufacture. And reduced exports further worsen the balance-ofpayments picture.
If and when a country commits itself to escaping this vicious circle, a long-term comprehensive recovery program needs to be planned. One difficult task in implementing a recovery program is the synchronization between internal efforts and external efforts. If the pressure on the current account balance is not relieved, internal efforts may not produce the results necessary to correct current account deficit. On the other hand, if internal efforts are not sufficiently comprehensive, then debt relief alone may not be adequate. In some cases, serious debt rescheduling negotiations might have to be delayed, in order to allow sufficient time for the lenders to judge the performance of the recovery program. For the borrowing country, acceptable rescheduling plans can generally be agreed upon, if the lenders believe in the recovery program. Therefore, a country facing current account deficits should at once implement a very comprehensive recovery program. The logic of this program should be explained to the public, and strong support from public opinion should be obtained, to ensure the long-term implementation of this program. Under these circumstances, the borrowing country can negotiate rescheduling agreements on much more favorable terms than otherwise.

## THE SCOPE OF RESCHEDULED FOREIGN DEBT 1978-80

Between 1978 and 1980 debt rescheduling agreements were reached by Turkey with other governments and with financial institutions. The rescheduled debts can be grouped in three categories:
I) Credits obtained under bilateral agreements with the coordination of the Turkish Consortium formed in the OECD, including principal and interest on debts maturing before 1980, as well as those to mature before June 30, 1983. Foreign debt in this category amounted to $4.9 billion.
2) $2,259 million of convertible Turkish lira deposit (CTLD) accounts opened in Turkish banks by international commercial banks during 1976 and 1977; $429 million of banker's credit incurred by the Turkish Central Bank to foreign correspondent banks; and $98 million of third party reimbursement claims (TPRC). (Total: $2.8 billion)
3) Non-guaranteed trade arrears (NGTAs), amounting to $1.2 billion. These were considered to be important in improving our economic relations with foreign financial institutions and governments.

**THE CONDITION OF THE TURKISH ECONOMY DURING THE RESCHEDULING NEGOTIATIONS OF 1978-1979**

It is imperative to explain the condition of the Turkish economy during 1978 and 1979, when rescheduling talks were undertaken, so that the importance and the necessity of rescheduling will be better understood.

a) The Turkish economy in general

From the early 1960s until 1974, the Turkish economy grew in real terms between 6 per cent and 7 per cent per year. These years were characterized by relative price stability, manageable budget deficits, modest levels of external debt and a sound balance-of-payments position. Economic growth was achieved principally by high levels of investment and consumption in the public sector.

However, from 1974 through 1977, the effects of sharp oil price increases, as well as inflation, recession and rising unemployment in the industrialized countries adversely affected the Turkish economy. Over this period, both domestic and external factors contributed to deterioration in the terms of trade and balance of payments. Turkey's foreign trade policies encouraged a low degree of export orientation and an increasing dependence on imports. Imports rose at a greater rate than GNP, principally as a result of increased import prices. Export performance suffered from the world recession, non-competitive exchange rates and inefficiencies in the pricing of agricultural exports. And beginning in 1975, remittances of foreign exchange from Turkish workers abroad began to fall, reflecting rising unemployment among such workers and parallel market exchange rate differentials.

The resultant balance-of-payment deficits were financed almost exclusively through a reduction of reserves and increases in various short-term obligations, including the incurrence of arrearages. Growing public sector deficits were financed largely through borrowings from the Central Bank. Consequently, the money supply increased rapidly, and inflation accelerated.

By the end of 1977, the principal economic problems facing Turkey included a severe shortage of foreign exchange, a large balance-ofpayments deficit, a heavy burden of short-term external debt, high inflation, a large public sector deficit, a slowing of growth and increasing unemployment. The Government launched an economic

**TABLE I**
**Development of the Turkish External Debt Obligation**

| YEAR | SHORT-TERM | | MEDIUM- AND LONG- | | TOTAL |
|---|---|---|---|---|---|
| | $MIL. | % | $MIL. | % | |
| 1962 | | | 857 | 100.0 | 857 |
| 1967 | 123 | 8.5 | 1318 | 91.5 | 1441 |
| 1972 | 19 | 0.7 | 2519 | 99.3 | 2538 |
| 1973 | 279 | 8.6 | 2984 | 91.4 | 3263 |
| 1974 | 216 | 6.2 | 3280 | 93.8 | 3496 |
| 1975 | 115 | 24.4 | 3579 | 75.6 | 4734 |
| 1976 | 305 | 41.7 | 4263 | 58.3 | 7313 |
| 1977 | 611 | 52.5 | 5579 | 47.5 | 11643 |
| 1978 | 717 | 52.0 | 6618 | 48.0 | 13794 |
| 1979 | 355 | 26.13 | 10048 | 73.87 | 13604 |
| 1980 | 248 | 16.34 | 12693 | 83.66 | 15173 |

| 1981 | 211 | 13.6 | 13408 | 86.4 | 15519 |
|---|---|---|---|---|---|
| 1982 | 209 | 12.92 | 14092 | 87.08 | 16183 |

Source: Ministry of Finance Central Bank

stabilization program in early 1978 to correct these problems. The principal elements of this program included devaluing the currency, reducing the consolidated budget deficit, limiting Central Bank lending and raising prices of the State Economic Enterprises (SEEs). However the situation continued to deteriorate because of the lags between policy decisions and implementation, failure to effect a major tax reform, delays in raising new funds, continuing public finance problems (arising from increasing operating deficits of the SEEs), and large wage increases. During 1979, SEEs' prices were raised further, interest rates for both deposits and loans were increased, and the currency was devalued again. Despite these measures, macro-economic indicators continued to move downward.

b) The foreign debt position

As a result of the 1973 oil price increase-and the failure to take the necessary measures at the right time-the balance-of-payments picture deteriorated to a great extent. Balance-of-payments deficits were largely financed by short-term borrowings such as CTLDs.

Table I shows the foreign debt between 1962 and 1982 with percentages of short-term and medium- to long-term obligations. As can be observed from table I, up until 1975 over 90 per cent of external debt was medium- or long-term. After 1975, short-term obligations increased rapidly to reach a maximum level of 52.5 per cent in 1977. As a result of reschedulings, short-term obligations were reduced to 26 per cent in 1979, 16 per cent in 1980 and 13.6 per cent in 1981. Detailed composition of external debt with respect to countries and financial institutions is given in table II.

c) Balance-of-payments position

The Turkish balance-of-payments position between 1977 and 1983 is given in table III. As can be observed, the short-term export and import credits coupled with CTLDs were used to finance imports and to service the debt in 1977. After the second half of 1977, import transfers-excepting the most critical and urgent-were stopped. Delays in servicing foreign debts had also begun. In 1978, NGTAs completely disappeared. These restrictions reduced imports, and the difficulties caused by foreign currency shortage were multiplied. Imports with "cash-against-goods" and "acceptance" credits completely disappeared, making the situation yet more difficult. In addition, foreign commercial banks increased their coverage requirements to full value of the letter of credit. All credit lines were frozen. These actions further increased the foreign currency shortage and made the functioning of the economy more difficult still.

## DEBT RESCHEDULINGS REALIZED BY TURKEY

Stabilization programs were first prepared in 1978, and another program was put into action in 1979. The first reschedulings were performed during these programs. As these programs were not comprehensive, their results were not sufficient to enable the negotiation of reschedulings with realistic terms.

At the beginning of 1980, the Turkish economy was not strong enough to service the debts already rescheduled in the second half of 1978 and again in 1979. So after the January 24, 1980 stabilization program, a new rescheduling was needed to bring debt service obligations more into line with Turkish balance-of-payments projections. The projection for principal and interest

payments on external debt as of December 31, 1979 is shown in table IV. In the reschedulings of 1980, the major portion of debt repayments was

TABLE III: Balance of Payments
(mmma9 of dollars)

| | 1977 | 1978 | 1979 | 1980 | 1981 | 1982 | 1983[1] |
|---|---|---|---|---|---|---|---|
| Cur account | | S2.28 | $2.26 | 52,91 | $4.70 | (5.74 | 56,40 |
| E..n..ts | | tod8 | 1 | 0 | 7 | 6 | |
| Imports. | | c.i((4,59 | (SD6 | | (8,93 | (8.73 | (9,44) |
| Balance of trade | | (2,31 | (2.80 | (4_99 | (4,23 | (298 | (2.800) |
| Workers remittances | 982 | 983 | 1.694 | 2,071 | 2.490 | 2.18 | 2.250 |
| Tourism and travel | 20 | 146 | 179 | 210 | 277 | 262 | 275 |
| Interest payments | | (407) | (546) | (668) | (1,19 | (1.46 | (1300) |
| Profit transfers | | | | | | (43) | (50) |
| Other invisihies | 139 | 207 | 362 | 277 | 672 | 990 | 1.050 |
| Balance of invi5ible | 772 | 929 | 1 689 | 1,886 | 2,246 | 1,931 | 2,225 |
| Current aocountbalance | | (1,38 | | (3,11 | (1,98 | | (575) |
| Capital account project credits | 310 | 450 | 356 | 547 | 642 | 754 | 875 |
| Program credits | 99 | 257 | 712 | 1X44 | 840 | 1,007 | 450 |
| Debt repayments | (214) | (266) | (544) | (575) | (551) | (852) | (1.050) |
| Acceptance credits | .... | 302 | (577) | (58) | (147) | 69 | 50 |
| Private foreign capital' | .185 | 179 | 220 | 146 | 129 | 104 | 130 |
| Other capita] transactions | 409 | 257 | 54 | 82 | (34) | 93 | 24 |
| Capital account balance | 1.179 | | | | 879 | 1,17 | 715 |
| S DR allocations | - | | 27 | 27 | 24 | | |
| Errors and omissions | (576) | (231) | 785 | 1.070 | 1,016 | 97 | |
| Ommllbalance of payments | | (434) | (86) | (7o | (65) | 214 | |
| Financing | 1,348 | 434 | 86 | 70 | 65 | (214) | (140) |
| Monetary authorities | 2,526 | _ | 100 | | 351 | (121) | (151 |
| Assets | 562 | (139) | 5 | (513) | 228 | (332) | (4007 |
| Liabilities | 1,967 | 1705 | | 404 | 123 | 21 | 385 |
| IMP | I8 | 170 | | | 735 | | 135 |
| CTLOS | 198 | 882 | | 72) | (69) | | 50 |
| Ores4nerBank program | 190 | | | | 108 | | 250 |
| Bank Forlmernaunnal Settlements | 40 | (190) | - | | | | |
| Bankers'm'Nis | (27) | (51) | 96 | | (10) | - | |
| Arrears onC7LOS | 289 | (45) | (46) | | | | |
| TPRC5 | 130 | | | | | | |
| NOTAs | 166 | 52 | | (227) | | | |
| Overdrafts | 116 | 101 | (97) | 10 | (185) | (21) | (50) |
| Other | (91) | 196 | 199 | 199 | 156) | (430 | |

Commercial banks .........6 (I8) (36) (94) (42) (150 (125)
Reevaluation account ..(184) (714) 22 273 126

Source: Mini'-: O ' Of rina e, S (ure Planning Orgnntallon.' Central Ln
(3) Estimate.

TABLE IV (Part I)
Estimate of Turkey's Medium and Long-Term External Debt Position and Debt Service as of 31st December 1979

| | Prin. end 1979 | PAYM N SIN | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | 1980 | | 1981 | | 1982 | | 1983 | |
| | | Prin | Int | Prin | Int | Pnn | 111 | Pnn | hit |
| I. Multilateral creditors | 2929.5 | 1574 | 164.5 | 111.1 | 155.1 | 128.5 | 146. | 172.0 | 139. |
| IDA | 191.1 | 1.1 | 1.5 | 1.2 | 1.4 | 1.7 | 14 | | 14 |
| BR D | 1757 0 | 44 2 | 117 9 | 56 6 | 114 2 | 71 9 | 109 8 | 98 7 | 103 6 |
| I FC | 79.8 | 30.2 | 7.2 | 25.5 | 4.4 | 10.9 | 2.2 | 5.4 | '.2 |
| BIB | 627 9 | 11 9 | 21 7 | 14 5 | 21 0 | 17 5 | 20 2 | 23 4 | 203 |
| European Resettlement Fund | 190 0 | 12 9 | 12 9 | 11 7 | 11 9 | 26 5 | 10 9 | 41 9 | 8 8 |
| Islamic Dcselonment Bank | 83.7 | 52.1 | 3.3 | 1.6 | 2.2 | | 1 7 | | 38 |
| II. Bilateral creditors | 8169.7 | 5890 | 3764 | 803.7 | 3912 | 784.0 | 339.7 | 883.9 | 285.1 |
| I.OECDMember countries | 7139.1 | 537.5 | 316.5 | 703.0 | 335.5 | 7032 | 288.5 | 801.7 | 240.7 |
| a. official and guaranteed private loans | 5220.3 | 2653 | 171.0 | 436.2 | 230.6 | 451.2 | 203.0 | 480.5 | 175.2 |
| b. Rescheduled debt- 1978 | 1140 3 | 196 3 | 926 | 2257 | 56 5 | 2259 | 40 1 | 224 6 | 27 4 |
| e. Rescheduled debt- 1979 | 7785 | 75.9 | 52.9 | 41.1 | 48.4 | 26.1 | 45.4 | 99.6 | 38.1 |
| 2. Eastern Bloc countries | 683.7 | 42.6 | 474 | 89.5 | 431 | 69.9 | 38.6 | 70.8 | 33.0 |
| 3. Oil producing countncs | 314.3 | 34 | 10.1 | 5.4 | 10.5 | 5.1 | 10.1 | 5.9 | 9.9 |
| 4. Other | 32.6 | 5.5 | 2.4 | 5.8 | 2.1 | 5.8 | 1.9 | 5.5 | 1.6 |
| 111. Private credits | 4720.9 | 162.3 | 5893 | 219.1 | 508.7 | 431.8 | 421.4 | 889.0 | 357.2 |
| Total | 15820.1 | 903.7 | 11301 | 1133.9 | 1055.0 | 1344.3 | 906.7 | 19449 | 781.5 |

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TABLE W (Part 2)
Estimate of Turkey's Medium and Long-Term External Debt Position and Debt Service as of 31st December 1979

| | PAYMENT | | | | | | | | | | Pnn' end 1988 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | 1984 | | 1985 | | 1986 | | 1987 | | 1988 | | |
| | Prin | Int | Prin | lit | Prin | Int | Prin | lit | Prin | Int | |
| 1. Mwtibteral creditors | 151.8 | 134.1 | 172.3 | 124.0 | 192.6 | 118.0 | 182.7 | IM.? | 160.6 | 93.4 | 1 505.5 |
| IDA | 29 | 1.4 | 3.5 | 13 | 3,9 | 1.3 | 3.9 | 1.3 | 3.9 | 1.3 | 166.4 |
| IBRD | 1038 | 1019 | 127 1 | 98 1 | 130 7 | 94 5 | 133 6 | 84 0 | 123 9 | 74 9 | 866 4 |
| IFC | 3 6 | 1 7 | 24 | 0 4 | 68 | 0 1 | --- | | - | - | |
| EIB | 27 2 | 20 3 | 24 9 | 16 7 | 24 7 | 15 5 | 22 2 | 14 5 | 22 7 | 13 5 | 438 9 |
| European Resettlement Fund | 88 | 58 | 89 | 5 0 | 22 0 | 4 8 | 13 5 | 42 | 10 1 | 3 1 | 33 7 |
| Islamic Development flank | 5.5 | 30 | 5.5 | 2.5 | 9.5 | 1.8 | 9.5 | 0.7 | - | - | - |
| U. Bilatenlcredkors | 737.5 | 225.5 | 6973 | 1183 | 534.8 | 137.5 | 477.8 | 106.9 | 357.4 | 82$ | 2232.0 |
| I.OECD Member Countries | 6262 | 1887 | 598.7 | 148.3 | 442.0 | 113.9 | 390.6 | 88.1 | 272.5 | 67.8 | 19914 |
| a. Official and gourmet | 383.0 | 147.3 | 365.8 | 21,9 | 3248 | 101.4 | 3003 | 82.6 | 229.2 | 67.8 | 1984.7 |
| b. Rescheduled debt-- 1978 | 100 5 | 12 3 | 90 2 | 4 8 | 0 | | 0 | | | 0 | 4 1 |
| c. Rescheduled debt- 1979 | 142J | 20.9 | 142.7 | 21.6 | 117.2 | 12.5 | 90.1 | 5.5 | 433 | 0 | 1,6 |

| | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| 2. Eastern Bloc countries | 84A | 26.3 | 71.1 | 21.3 | 70.3 | 16.5 | 64.7 | 2,4 | 64.8 | 9.4 | 54.6 |
| 3. Oil producing countries | 20.9 | 9.1 | 22.5 | 7.9 | 225 | 7.1 | 22.5 | 6.4 | 20.1 | 5,6 | 186.0 |
| 4. Other | 5.0 | 1.4 | 50 | 0.8 | - | - | | | - | - | |
| ILL. Privatecredib | 918.0 | 356.7 | 911.0 | 159.0 | 629.7 | 70.0 | 136.0 | 37.0 | 136.0 | 27.0 | 2880 |
| Total | 1807.3 | 6163 | 1780.6 461.3 | | 1351.1 | 325.5 | 796.5 | 248.6 | 654.0 | 203.2 | 4025.5 |

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TABLE V (Part 1): Debt Service Requirements of Medium and Long Term Disbursed and On disbursed External Debt' (As of December 31, 1952)

| | 1983 | | 1984 | | 1985 | | 1986 | | 1987 | | 1988 | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Prin. | Ins. | Prin. | Ins. | Prin. | Ins. | Prin. | Ins. | Prin. | Int. | Prin. | Ins. |
| Public sector | 194 | 226 | 203 | 219 | 259 | 219 | 312 | 257 | 349 | 263 | 352 | 2411 |
| Bilateral credits | 619 | 197 | 605 | 206 | 585 | 181 | 529 | 151 | 448 | 129 | 399 | 103 |
| OPEC countries | 36 | 16 | 23 | IS | IS | 15 | 39 | 14 | 53 | 13 | 51 | 13 |
| Othcreountries .................. | 28 | I9 | 39 | 16 | 36 | 12 | 32 | 11 | 29 | 9 | 28 | 7 |
| | 683 | 232 | 667 | 237 | 636 | 208 | 600 | 176 | 530 | 151 | 478 | 123 |
| Commercial bank loans | - | 53 | 20 | 48 | 81 | 41 | 81 | 32 | 81 | 22 | 81 | 13 |
| Other loans ....................... | 71 | 65 | 146 | 56 | 226 | 40 | 53 | 14 | 29 | 8 | 12 | 5 |
| Rescheduled short-term debt | - | 206 | 67 | 183 | 399 | 161 | 400 | 124 | 399 | 87 | 399 | 50 |
| Bankers' credits | - | 57 | 22 | 51 | 86 | 43 | 86 | 34 | 86 | 24 | 86 | 13 |
| IPCRs .................................. | 34 | 10 | 50 | 4 | | | | | - | | | |
| | 105 | 391 | 305 | 342 | 792 | 285 | 620 | 204 | 595 | 141 | 578 | 81 |
| Private sector | 59 | | 46 | 10 | 51 | 6 | 28 | 4 | 18 | 2 | 12 | 2 |
| NGTAs² | | | | 20 | 53 | I8 | 52 | IS | 53 | 12 | 52 | 9 |
| | 59 | 45 | 46 | 30 | 104 | 24 | 80 | 19 | 71 | 14 | 64 | II |
| Total debt service | | | | | 1,791 | | 1 612 | | 1,545 | 1 | 472 | |
| Principal | 1,041 | | | | | | | | | | | |
| Interest ................................. | | 894 | | 828 | | 736 | | 656 | | 569 | 455 | |
| total ..................................... | 1935 | | 2,049 | | 2,527 | | 2268 | | 2114 | | 1927 | |

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TABLE V (Part 2): Debt Service Requirements of Medium and Long Term Disbursed and Undisguised External Debt' (As of December 31, 1982)

| | 1989 | | 1990 | | 1991 | | 1992 | | 1993-2022 | | Total | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Prim. | Int. | Prim, | Int. | Prin. | tent. | Hhi. | Hit. | Prin. | Int. | Prin. | Int. |
| Public sector | 373 | 219 | 395 | 195 | 343 | 170 | 352 | 161 | 1L7_54 | 564 | 4_,8_86 | |
| International organizations.. | | | | | | | | | | | 2,733 | |
| Bilateral credits | 304 | 92 | 270 | 77 | 221 | 68 | 160 | 41 | 2,560 | 392 | 6,700 | 1,637 |
| Participating OECD Countries | | | | | | | | | | | | |
| OPEC countries ................ | 50 | 10 | 50 | 9 | 49 | 8 | 49 | 7 | 172 | 9 | 587 | 129 |
| Other countries .................. | 26 | 6 | 24 | 5 | 23 | 4 | 22 | 3 | 245 | 70 | 532 | 162 |
| | 380 | 108 | 344 | 91 | 293 | 80 | 231 | 51 | 2 977 | 471 | 7,819 | 128 |
| Commercial bank loans | 60 | 3 | - | | | | | | | | 404 | 212 |
| 19791oan ........................... | | | | | | | | | | | | |
| Other loans ........................ | 12 | 8 | 7 | 3 | 8 | | 7 | I | - | | 571 | 202 |
| Rescheduled short-term debt | 332 | 14 | - | | | | | | - | | 1,996 | 825 |
| CTEDS ............................ | | | | | | | | | | | | |
| Bankers' credits ................. | 63 | 4 | - | | | | | | | | 429 | 226 |
| TPCRs ............................... | | | | | | | | | - - | | 84 | 14 |

| | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | 467 | 29 | 738 | | 2 | 7 | I | | | 3y84 | 1,479 |
| Private sector | 5 2 | 5 | 2 | | 5 2 | 5 | I | 26 | 6 | 260 | 50 |
| Private credits ..................... | | | | | | | | | | | |
| NGtAs' ................................ | 70 | 5 | 70 | 1 | -- | | - | - | - | 350 | 112 |
| | 75 | 7 | 75 | 3 | 5 2 | 5 | I | 26 | 6 | 610 | 162 |
| Total debt service | 1,295 | | 821 | | 649 | 595 | | 4757 | | 12999 | |
| Principal | | | | | | | | | | | |
| - | | | | | | | | | | | |
| Interest | 363 | | 292 | | 254 | | 214 | 1041 | | 63_02 | |
| ............... | | | | | | | | | | | |
| Total .................................. | | | | | 903 | | 809 | 5798 | | 233NI | |
| | 1,658 | | 1,113 | | | | | | | | |
| n r | d w,NOnl | | | | enwn | | | | | 0 | |
| IVe | mcdlohedi,huw-0 | | | | 4[lingaipeccrn&r31.19&l.AIlmw %oRioenreprpse..io~,.Thepmfmbn P | | | | | | |

spread to the period after 1983, at which time the stabilization program would start producing positive results. Table V shows debt repayment until 1990 after all reschedulings have been completed. In case of any unforeseen difficulty! OECD has made a standing promise to reschedule debts maturing between 1983 and 1985. Most probably, there will be no need for this.

After the stabilization program of January 24, 1980, the reschedulings undertaken with OECD and the financial institutions proved to be very helpful. With support from the IMF and World Bank, the reschedulings gave sufficient relief to the Turkish economy to restore its main functions.

a) The rescheduling of debts to OECD countries

Because of balance-of-payments difficulties beginning in 1977, the principal and interest payments on short- and long-term loans obtained from OECD countries could not be made on time. In the second half of 1978, as a result of dicussions carried on with the OECD, $1.2 billion of debt was rescheduled with the following terms:

- short-term loans (maturing between January I, 1977 and May 20, 1978):

20% starting September 30, 1978, every 6 months, 4 installments 80% starting June 30, 1980, every 6 months, 8 installments

- long-term loans (maturing between January 1, 1978 and June 6, 1979):

20% starting December 31, 1978, every 6 months, 4 installments
80% starting June 30, 1981, every 6 months. 10 installments

The rescheduling of 1978 did not give any relief. This became obvious in 1979, when a second rescheduling was necessary for previously rescheduled obligations. In 1979, after discussions with the OECD Secretariat, an amount equal to $828 million was rescheduled with the following terms:

- short-term loans (maturing between May 21, 1978 and June 30, 1979):

15% starting April l, 1980, every 6 months, 3 installments 85% starting July 1, 1982, every 6 months, 8 installments

- long-term loans (maturing between July I, 1979 and June 30, 1980):

15% starting April I, 1980, every 6 months, 3 installments 85% starting July 1, 1982, every 6 months, 10 installments

This second round of rescheduling was as useless as the first. The Turkish balance-of-payments situation was not strong enough to make these payments-neither in 1978 nor in 1979.

Thus far, the rescheduling did not provide any relief, and so, after the implementation of the January 24 stabilization program, a new rescheduling was absolutely necessary to give fresh life to the Turkish economy and to correct its

balance-of-payments picture. The noteworthy aspect of this latest rescheduling is that it is tailored to improvements in the Turkish balance-of-payments situation. Because of this and the continuing improvements in the Turkish economy, no further rescheduling has been necessary. All payments are being made according to the latest rescheduling with no difficulty.

The conditions of the rescheduling agreement reached in 1980 are as follows:

rescheduling of debts already rescheduled in 1978 and 1979 (loans matured but not paid by June 30, 1980 and loans maturing between July I, 1980 and June 30, 1981):

10% starting January 2, 1981.4 equal yearly installments

90% starting July I, 1984, every 6 months, 8 installments

first-time rescheduled debts (loans matured but not paid by June 30, 1980 and loans maturing between July I, 1980 and June 30, 1983):

**10% starting in 1980, in 5 equal yearly installments**

90% with 5 years grace and 5 yearly installments

The total amount of Turkish debt rescheduled with OECD countries in 1980 is $2,887 million. A detailed account of the rescheduling agreements on a country basis is given in table VI.

b) Transformation of CTLDs to medium-term loans

The rescheduling effort for Colds started concurrently with the OECD debt rescheduling. Approximately 240 commercial banks, with a total amount of $2.3 billion were involved. Clearly, it is an extremely difficult task to negotiate with 240 different banks and to reach consistent rescheduling conditions. Therefore, technical assistance from financial advisory firms was needed to conduct these negotiations.

The conditions of the first rescheduling agreement on CTLDS were as follows:

a 7-year term and 3-year grace period, with interest set at LIBOR plus 1.75.

**However, as was the case with OECD debts, after the January 24**

measures, the rescheduling of CTLDS had to be redone to ease the burden on the balance-of-payments situation. The result of the final rescheduling is a ten-year term with a five-year grace period. The interest remained at the same level of LIBOR plus 1.75. The total amount of this debt is $2,269 million.

c) Rescheduling of banker debts and TPRCs

The Turkish Central Bank's debt to correspondent banks, which amounted to $429 million, was rescheduled at first with a seven-year term and three years grace. These conditions were changed to a ten-year term with five years grace in 1980. Third party reimbursement claims (TPRCs), which amounted to $98 million, were rescheduled with a three-year term and LIBOR plus 1.5 interests.

d) Rescheduling and payment of non-guaranteed trade arrears

Due to a lack of foreign currency, import payments were made through cash-against-goods and acceptance credits, beginning in 1976, and by December 31, 1981, non-guaranteed trade arrears amounted to $1.2 billion. To solve this relatively complex problem, the government employed a different approach from that used for other debts. In January 1980, Turkey proposed a program of phased elimination of arrears relating to cash-against-goods, which had become the Central Bank's short-term liabilities. Under this program, the creditors could have their claims settled either in Turkish liras or in five foreign currencies. Local currency obtained under the Turkish lira option could be used for investment in specified sectors, including production for exports, investment and equity participation, credit extension to importers in Turkey, and for payment of taxes. Under the foreign currency option, repayments would be made over ten years with four years of grace. With 8500 claimants and 90,000 files, the foreign currency option amounted to $350 million, while the claimants holding the remaining $850 million worth of arrears preferred the Turkish lira option. Recently, a decree was issued allowing CTLDS to be used as Turkish liras, but so far, there has been little demand for this option.

## CONCLUSION

Debt rescheduling is an extremely difficult and unpleasant task. The international banking community carries a heavy responsibility in this effort today, because so many countries face severe problems in servicing their debts. The banks seem to be aware of this responsibility. Without this awareness, there is a great danger that large defaults would occur and the problems would become much worse.
Countries facing a debt rescheduling problem must recognize that the first need is to design and implement a good recovery program. Recovery programs must be explained to the public, and support should be obtained. Otherwise, the implementation of the recovery program may face difficulties.
Rescheduling should be designed to allow the country to take a fresh breath, leaving sufficient funds to revive its economy. Otherwise, no recovery can take place. Last but not least, by self-discipline in implementing a recovery program, a country can prevent similar critical situations from arising in the future.

# CHAPTER 16
# Africa in the Current International Crisis
**B.C. Muzorewa**

## INTRODUCTION

Africa has been singled out as the poorest continent of the world. Recently, six more African countries were added to the list of the countries classified as the least developed. Thus, 26 of the world's 36 least developed countries are located on the African continent. The extent of Africa's economic predicament can be appreciated more by looking at a few indicators.
In 1980, well over 50 per cent of the population of Africa south of the Sahara was living in absolute poverty.' This proportion must have increased by 1983, since more countries have been sliding into deeper poverty as a result of the devastating 1980-1982 recessions. An examination of the per capita GOP growth rates (in constant 1970 prices) in Africa between 1977 and 1981 reveals that 23 out of the 50 independent countries registered negative growth rates.' When the full impact of the 1980-1982 recessions is taken into account, the situation must now be worse than indicated here.
Since the backbone of Africa's economy is agricultural production, the extent of poverty can better be indicated by per capita foal production. During the past two decades, the index of per capita food production in Africa has declined dramatically by 20 percentage points, while the same index has increased by about 15 percentage points over the same period in other Third World regions.
From the above indicators alone, it is quite clear that the African continent is not only underdeveloped but in fact underdeveloping. The basic causes of Africa's crisis are well documented. In the area of agricultural production, inappropriate production incentive policies have been the main constraint on growth in incomes and export earnings. Low growth in incomes has been accompanied by very high rates of growth in population. Less efficient utilization of borrowed funds has not only contributed to the low rates of income but also to the external debt servicing problems. Domestic surplus has not been fully tapped, due to lack of appropriate incentives to save. Hence the heavy reliance on external borrowing.
In addition to the internal causes, it is now generally agreed that the external environment has greatly aggravated the African predicament, Within the context of the North-South relationship, it is essential to examine in detail Africa's economic and social plight visa-vies the current international crisis,

## THE NATURE OF THE INTERNATIONAL CRISIS AND LINKAGES WITH THE AFRICAN ECONOMY

The first oil crisis of 1973-1974 was followed by a decline in the growth of world trade from 12.5 per cent in 1973 to -4.0 per cent in 1975. However, the growth of world trade rose again to 6.5 per cent in 1979. But partly as a result of measures taken to bring down inflation by the North, world trade continued to decline from 6.5 per cent in 1979 to an estimated -2.0 per cent in 1982. The recession of 1980-82 was also prolonged by tight monetary policies of the developed countries? The decline in trade due to falling demand in industrialized countries was reinforced by the new protectionist measures by the North in the face of rising levels of unemployment. The protectionist measures were directed at both agricultural and industrial products of the South.

In the case of Africa, the main sectors affected were agriculture and mining. The decline in industrial and consumption demand in the North inevitably resulted in the collapse of commodity prices, which aggravated the crisis in Africa. According to the World Bank, the average annual percentage change in prices of nonfuel primary commodities declined from positive 6.6 per cent between 1973 and 1980 to -7.0 per cent in 1981, and to an estimated -12.0 per cent in 1982.^ When it is considered that, for some 13 oil-importing African countries in 1981, primary commodities constituted over 70 per cent of their total exports of goods and services, the devastating effects on the African economy of the collapse in nonfuel commodity prices can be appreciated. And the slow progress towards commencement of the operation of the Common Fund for Commodities has not helped to mitigate the problem. t Wortd Bank, World Development Report, 1983 (Washington D.C.). °World Development Report, 1983.

The prolonged inflation in developed countries also meant higher prices of imported raw materials, capital goods and other inputs for the South. The result has been deterioration in the terms of trade for the Third World. During the period 1979-82, of all regions of the Third World, Africa suffered the greatest decline in terms of trade and purchasing power of exports: -15.3 per cent and -3.5 per cent respectively Such negative trends in the export purchasing power of African countries can only aggravate the economic conditions of the continent, as imports even of essential food and production inputs become difficult, if not impossible.

The discussion so far has concentrated on the trade link between Africa and the North. There is a finance link which is equally, if not more disturbing. As already observed, the industrialized countries used monetary measures in order to bring down inflation. In the United States, for example, interest rates went as high as 21 per cent. For Africa, south of the Sahara, interest rates on public loans from all external sources increased from 4.4 per cent per annum in 1972 to 10.1 per cent in 1981.[6] While the interest rate on debt from official sources increased over the same period from 3.1 per cent to 5.2 per cent, that on debt from private sources increased from 6.7 per cent to 14.2 per cent. While the average interest rate on public debt from all sources has more than doubled over this period, the proportion of the debt carrying variable interest rate increased from 4 per cent to 20 per cent. Thus, the interest payments burden for these sub-Saharan African countries increased dramatically from US $210 million in 1972 to an unprecedented level of US $2,007 million in 1981,a tenfold increase.

Partly due to the greater availability of petrodollars in the hands of commercial banks of the North and partly because of the in creasing unavailability of official medium- and long-term loans, African countries resorted to greater use of private short-term bor rowing in order to finance development projects. The immediate result of this shift from official to private sources of finance has been the shortening of maturities on the overall debt. In 1972 the average

‘ maturity was 20.4 years. By 1981, the average maturity had declined to 15.8 years. This shortening of maturities has been another root cause of the debt-servicing problems of a growing number of African ‘Ibid.
‘World Bank, World Debt Tables 1982-1983 (Washington, D.C.). countries in recent years.
Another consequence of the recession, prolonged by the policies of the North, has been a decline or stagnation in the flow of official development assistance relative to private lending. With respect to sub-Saharan Africa, the share of the flow of official loans fell from 61 per cent in 1972 to 52 per cent in 1981. This development has taken place at the very time when Africa needs more medium- and long-term external resources to reverse the retrogression process described above. The effects of this development on the growth of productive capacity of these countries can only be negative, considering the widening gap between domestic resources and required domestic investment. For many of the poorest countries, a decline in official credit has not been offset by private credit, mainly because of their very low credit ratings. This catastrophic situation has been highlighted in the Libreville, Buenos Aires Platform and the UNCTAD VI documents.

## THE IMPACT OF THE INTERNATIONAL CRISIS ON THE AFRICAN ECONOMY

The decline in developed countries’ demand for agricultural and mineral products from Africa has had an adverse impact on production and employment in these poor countries. For the most part, African economies are dependent on agriculture and external trade. The capacity of African economies to borrow, to service their external debts regularly and to adjust to external shocks also is determined by changes in the demand for their products and the terms of trade they face. In short, whether Africa develops or slides into poverty depends in part on what happens in the area of production of and trade in primary commodities vis-à-vis the North. The developments in production and export commodities by African countries can be discerned from table I. Although the value of exports of 18 commodities of African countries increased from US $5.8 billion in 1970 to US $10.9 billion in 1981, the volume of these commodities actually fell from 65.6 million tons to 57.1 million tons over the same period.
But from the table it is clear that since 1976, the increase in the value of these commodities was not significant. The main cause of this slower increase between 1976 and 1981 is the decline in demand by the North, where 84.2 per cent of these African exports were

TABLE 1:

EXPORT OF 18 AFRICAN COMMODITIES

| Value: | 1970 | 1976 | 1981 |
|---|---|---|---|
| (US$ million) | 5.8 | 10.5 | 10.9 |
| Volume: | 65.6 | 65.4 | 57.1 |
| (million tons) | | | |

Source: UN Economic and Social Council, Commodity Structures, 1983).

Purchased in 1979. The real price index of world non-oil commodities (1975 = 100) rose to 109 in 1979 and thereafter declined consistently to 91 in 1982. Even in nominal terms, the index fell from 166 in 1980 to 125 in 1982.’ The collapse of non-oil commodity prices has hit hardest the least developed countries of Africa.
The immediate impact has been a decline in production, employment and social

services in these countries. As already indicated, changes in the purchasing power of exports of low-income Africa and changes in the terms of trade have been negative for some time. This made it necessary to cut down the importation of essential raw materials, capital goods and, therefore, investment. Given long-term factors such as the rate of growth in population, the inevitable result was a decline in per capita income for most of Africa. The decline in per capita income defeated efforts to raise the domestic savings ratio, which has been low. Savings in low-income Africa were only 8.8 per cent of GDP in the 1970s and, it is estimated, will decline almost to 5.0 per cent in the 1980s e

The current crisis can also be traced via the monetary and financial link. As exports decline and costs of imports increase or remain static, deficits on current account of the balance of payments emerge. It is now generally accepted that a large proportion of the current account deficits of developing countries can be attributed to external factors.

For low-income Africa, the deficit rose continuously from US $2.6 billion in 1978 to US $5.5 billion in 1981, where it is estimated to have remained in 1982.[4] When non-oil Africa as a whole is considered, the deficit on current account increased from US $6.5 billion in 1979 to US $18.6 billion in 1981 and then dropped to US $16.3 billion in 1982.1^ In an effort to finance these growing deficits, African countries have resorted to short-term private sources, largely because of the increasing unavailability of long-term funds from both private and official sources.

At the same time, rising interest rates, due to restrictive monetary policies of industrialized countries of the North, and falling export earnings make it extremely difficult and in many cases impossible to service the external debt. As external debt payments arrears have accumulated, the result has been a reduced inflow of external finance, particularly concessional finance. Many countries have resorted to short-term borrowing, which also has faced a sharp rise in interest rates. The debt service ratio of Africa as a whole rose to 28 per cent in 1982, much higher than is considered safe. While some countries have been successful in restructuring their debts, others are still caught in the "debt trap."

The increase in the debt burden has caused many African countries to cut down on further borrowings to finance development projects. For countries which managed to maintain their creditworthiness, it has been possible to continue borrowing to finance current account deficits and interest payments. Thus, external borrowing has been increasingly divorced from economic and social development purposes. External finance is no longer supplementing domestic savings as it did before the current international economic crisis.

In those countries borrowing for balance of payments and interest payments purposes, implementation of otherwise productive development projects has had to be suspended. Some productive projects already implemented have become idle due to the lack of additional foreign finance to purchase inputs and spare parts. Consequently, production and employment have been reduced, in turn triggering social and political instability. The current international crisis has made many countries in Africa, particularly the least developed, absolutely desperate, as was emphasized by one African spokesman, who said, during the recent negotiations between the ACP (African, Caribbean, and Pacific) countries and the European Economic Community countries:

Several of our countries face graver threats to their survival today than at any other time in their history. Our situation threatens to be a permanent one.

It can therefore be said that, although the international recession has had varied degrees of impact on developing countries, those in Africa, where the majority of least developed countries are located, were hit hardest. Because of stagnating or declining foreign exchange earnings and reduced inflows of foreign finance, cutbacks have been made in imports of raw materials and capital goods and in investment programs. The combined effect has been a sharp curtailment of growth in these countries.

**ADJUSTMENT BY AFRICAN COUNTRIES**

The dominance of external factors in shaping the development of the African economy has forced countries in the region to resort to painful adjustment processes. Currently, some 23 African countries are negotiating adjustment programs with the IMF which are meant to alleviate the pressures of the international recession. Given the already very tow incomes in most of Africa-as well as natural and recurrent problems such as drought and crop failure-it is not surprising that only about one-fifth of these countries have been able to meet the macro-economic targets set for them by the IMF. Quite often, the inability of African countries to meet targets does not imply that these countries have not made efforts to adjust.
On the contrary, many African countries recognize the necessity to adjust and have taken stringent austerity measures. Budget deficits have been reduced and income taxes increased, salaries and wages have been restrained, import demand has been contained, and improvement in production incentives has been made. The rate of inflation in
k Africa as a whole has dropped from 26 per cent in 1981 to 16 per cent in 1982.[1’]
However, there is a limit to the extent to which a poor ; INry, extremely weak in relation to the international forces, can goon adjusting without causing social and political instability. This al United Nations Services. Number 833 (26 August 1983).
Civil unrest has already been manifested in some countries which have or are currently seeking IMF support. Such unrest can only worsen the situation by reducing the creditworthiness of these countries, causing new loans to dry up.

**According to one view:**

The poorest countries are those in which adjustment is likely to be particularly sluggish- so that the degree of stock required to achieve the desired effect may be even greater than that which the same adjustment requirements and shortages of liquidity would necessitate in more flexible economies.”
As long as the IMF continues to apply the narrow monetarist approach to African countries’ balance of payments problems, its stabilization targets are not likely to be met. The problem of imbalances in African countries is a structural one and requires medium- and long-term bridging finance. This type of finance can only come from official sources in the North.
African countries have not been meaningfully assisted by the North in their adjustment efforts. In 1979, only three African countries had to reschedule their external debts. By 1982, as many as ten countries sought debt relief. These current external debts rescheduling and refinancing are being tied to IMF adjustment programs which are necessarily of a short-term nature. Thus, external debt rescheduling is not taking into account the long-term development needs of the African debtor countries. In the end, the creditors always end up better off, as rescheduling has become -a profitable business for lenders and a very costly business to borrowers.[14]
One evidence of the impact of the current international crisis on African countries is the establishment of external debt management departments in most countries. Given the unfavorable climate for foreign financial inflows, all African borrowing countries are making serious efforts to put their houses in order. However, these efforts can easily be frustrated by external factors, such as sudden declines in demand for primary commodities, shortening of maturities, and sharp increases in interest rates. There is very little African countries can do about such exogenous events. Thus the need for more meaningful dialogue with the North. By meaningful dialogue here is meant a dialogue which results in cooperation, including a substantial increase in external finance on terms and

conditions more likely to assist African countries to manage their external debt as smoothly as possible or without disrupting their development programs.
In summary, it is essential to emphasize that the capacity of developing countries to deal with growth and adjustment requirements has drastically diminished in the face of the collapse in commodity prices, declining export markets, sustained deterioration in terms of trade and the need to service a rapidly accumulating external debt's This situation calls for a substantial increase in concessional financial inflows particularly for the poorest continent of Africa.

## PROSPECTS FOR AFRICA IN THE FACE OF THE CURRENT INTERNATIONAL CRISIS

As has been demonstrated already, a large number of African countries are sliding into deep poverty. Their economies are clearly more integrated into the world economy than was the case at independence. It is, therefore, unthinkable, at least in the foreseeable future, for Africa to cut its economic ties with the North.
Trade, money and finance links have grown stronger than before. The North has become more and more dependent on raw materials from the South and on Southern demand for manufactured products. This interdependence has become much clearer during the current international economic and financial crisis. Under these circumstances, it is obvious that the North needs to engage in a meaningful dialogue with the South. Since the African countries are extremely weak in relation to external forces, the North has an obligation to bend backwards in negotiations with African countries.
Trade relations between Africa and the North have a great potential for expansion. The observed declining trend in trade between African, Caribbean and Pacific (ACP) countries on the one hand and the European Economic Community on the other hand must be reversed. The capacity of ACP countries to import essential inputs for economic and social development depends heavily on increased 'demand for their products from the North. Such a sustained increase in demand for their products could contribute significantly to the reversal of their current slide into deeper underdevelopment.
An increase in demand for African products can be facilitated by removal of protectionist measures currently facing these countries. The proposal by the ACP/EEC Commission that duty-free access for ACP countries should also cover products covered by the Common Agricultural Policy of the EEC should be welcomed. However, this provision will not result in an increase in agricultural exports of the ACP countries to the EEC as long as non-tariff protectionist measures remain. It is hoped that the North will implement the UNCTAD VI resolution (TD/L.259) on protectionism, in which developed countries agree to work systematically towards reduction and elimination of quantitative restrictions and measures against developing countries' products.
The African economy could be revitalized also if the agreed measures to stabilize commodity prices were implemented as soon as possible. Considering the weak position of poor African countries, the major Northern countries need to take the lead immediately in ratifying the Common Fund for Commodities. It is through such schemes that African countries will be able to build up foreign exchange reserves with which to increase their contributions to the Common Fund for Commodities and similar funds, including the IMF quotas.
To prevent the collapse of African economies, the North must make every effort to keep the African trade gap from reaching the unmanageable proportion of 25 per cent of GDP projected for the year 2008.[16] The above measures against protectionism and commodity price instability, and the heightening of demand for African exports are important elements of this needed effort.
Adequate liquidity is a further prerequisite to successful balanceof-payments adjustment programs. The total inadequacy of liquidity available to African

countries has been the main cause of their inability to meet IMF adjustment program targets. Faced with declining foreign reserves and accumulating arrears, African countries have quadrupled their use of IMF credit between 1976 and 1981. Failure by the IMF to mobilize substantial additional resources could result in the catastrophic collapse of most African economies. Again, the North needs to take the lead in adequately funding the IMF so that it can liberalize its Compensatory Financing Facility, which is of great interest to most African countries.

The prospects for revitalization of the African economy can also be improved by an immediate increase in liquidity through the creation of special drawing rights (SDRs) and their reallocation in favor of the poor countries which need them most. The case for such a creation of SDRs has been convincingly articulated by the Group of 77 at UNCTAD VI. If the North is serious about dialogue with the South, here is an opportunity to demonstrate their political will to revitalize the world economy, particularly the economies of the poorest countries in Africa.

The gap between domestic savings and required investment in Africa continues to widen, and this will certainly persist into the foreseeable future. Given the very low incomes and therefore low domestic savings, the prospect for revitalization of the African economy will depend largely on a massive inflow of development finance from the North. As pointed out by UNCTAD VI, most of the external inflows required to revitalize the economies of countries with limited access to private inflows will have to be in the form of concessional finance)' According to estimates by the African Development Bank Group, Africa will require some US $1.7 trillion of external finance for the period from 1987 to 2000, in order to achieve an average annual growth in GDP of 4.5 per cent's A recent World Bank report acknowledges that an increasing number of African countries are going through a painful process of fundamental policy change, designed to improve efficiency of investment and production incentives. However, the report stresses that, unless such changes are accompanied by a massive inflow of external finance from the North, the benefits of these domestic policy changes will be lost.[19] And the World Bank report stresses that a larger proportion of these external inflows will have to be on concessional terms. Realization of such a magnitude of concessional inflows will largely depend on a much greater political will in the North than was demonstrated at UNCTAD VI.

Case studies of external debt rescheduling and refinancing by African countries reveal that if the terms of restructuring took into account the development needs of these countries, there would be no need for repeated debt renegotiation. The debt restructuring problems of African countries could be greatly alleviated if only the North implemented in full the UNCTAD Trade and Development Board resolution 222 (XXI), Part B, with particular attention to the agreed features of debt rescheduling that link debt relief to economic development needs of the debtor countries.

In conclusion, the African economic situation within the present international crisis is desperate indeed. While there is much that African countries themselves can do, there is no doubt that the role of the North is very critical. However, given the vast underdeveloped natural and human resources in Africa, the long-term prospects need not be dim. Sustained joint action between Africa and the North can reverse the disturbing trends shown in this paper.

# CHAPTER 17
## The 1983 World Development Report and the Growth Prospects of Sub-Saharan Africa: A Comment

**Shahid Jawed Build**

In this discussion of the prospects of the low-income developing countries-particularly those of sub-Saharan Africa-in the current situation of crisis, I will first describe the so-called “central scenario” of the 1983 World Development Report regarding the future of the developing world. I will next point out why some of the assumptions in the Report no longer seem valid, at least for the low-income countries of sub-Saharan Africa, and thirdly, will identify the measures that should be adopted by the international development community in order to prevent the decline of sub-Saharan Africa into a deep, possibly irreversible economic crisis.

The 1983 World Development Report presents scenarios not for the immediate future but for the period 1985-95. The reason for this can be stated simply; it was recognized that 1983-85 will be a period of adjustment, and that the policies that will have to be pursued in this period will be very different from those that must be followed in order to sustain long-term development. Under the central scenario, the rate of growth of low-income Asia is projected to be 4.9 per cent per annum, which translates into about 3 per cent per annum in GNP per capita. This is a fairly respectable rate of growth, almost equal to the levels of growth attained historically in this part of the developing world.

For Africa, the scenario projects a rate of growth of 3.3 per cent and this is only 0.1 per cent higher than the rate of population growth. It does not require very sophisticated analysis to conclude that, at this rate of growth, the impact on poverty would be scarcely consequential. In fact, since this figure would reflect an average of l;. growth, there would clearly be some decline in per capita income for
‘ The poorest 50 per cent of the population. However, even this projection for growth rates is highly optimistic, in view of a number of recent developments in the global economy. A more plausible rate of growth, according to my analysis, would be on the order of 2.5 per cent per annum-a rate of growth that could have very grim consequences for the economies of sub-Saharan Africa.

To demonstrate why 1 believe that the central scenario for Africa may be overly optimistic, let us look at the five basic assumptions on which these estimates are based. The first of these assumptions concerns DECD rates of growth. It is assumed that there will be a fairly quick recovery from the current recession, at least in North America, and that this process of recovery will then begin to have an impact in Europe and Japan. After the recession is over and recovery has taken hold, the industrialized countries could grow at the rate of 3.7 per cent per annum in the period 1985-95. This rate of growth in GDP of industrialized countries may turn out to be overly optimistic, since recovery in Europe has yet to begin and since it is not even entirely certain that the process that has begun in the U.S. can be maintained. There are already signs that interest rates may be rising, and there might be tightening of monetary policy. Even the rather modest rate of growth and rather modest recovery from recession assumed in the scenario-modest in the sense that these projected recovery rates are much lower than the rates experienced in previous recoveries from recession-may not be realized; the DECD economies may grow at a much lower rate.

The second set of assumptions behind the central scenario relates to various aspects of trade. It is assumed that the volume of world trade will expand at the rate of about 5.7 per cent per annum from 1983 until 1995. This rate of expansion in trade, over a period when the world gross national product is likely to increase by about 4.3 per cent per annum, means an elasticity of about 1.3 per cent, which is much lower than the elasticity experienced over the last two decades-on the order of 1.7 per cent. This reduction in elasticity implies some weakening of the link between the growth of the world output and growth in world trade.

It is further assumed that there will be a slight improvement in the terms of trade of the developing countries. The projection is that between 1983 and 1987, terms of trade of the developing countries will improve at a rate of about I per cent per annum, and after that they will stabilize. If the two assumptions about growth in the volume

of world trade and improvement in the terms of trade of developing countries are combined, it can be inferred that there will be a significant increase in the value of exports of developing countries. Are these assumptions valid at this time?
In contradiction of these projections, the prospects at least for the countries of sub-Saharan Africa appear very somber. For the moment, OECD recovery has not translated into a sizeable expansion in world trade, and it appears that the prices of the commodities of interest to the African countries may not show a strong recovery. Another World Bank study, Sub-Saharan Africa: Progress Report in Development Prospects and Program, projects that the index of the average prices of 11 commodities that account for over half of African exports will recover to 84 in 1990, as against a low of 72 in 1982, but will still be well below the index of 100 (based on 1975-80).
The third set of assumptions deals with capital flows. As is the practice, the Report divides capital flows into four categories. 1 will very briefly run through the estimates for each of these categories. It is assumed that net capital flows in the period 1985-95 will increase in nominal terms at the annual rate of 10 per cent. This translates
l into a real rate of growth of about 3.5 per cent. ODA flows-a very significant flow where sub-Saharan Africa is concerned-are assumed to increase at a rate of about 10 per cent per annum in nominal terms or 3.5 per cent in real terms. Official non-concessional flows such as those from the World Bank and its sister agencies are expected to grow at a slightly higher rate, about 11 per cent per ~~ annum. Private direct investment is expected to grow most rapidly about 11.5 per cent yearly. Because of the need for indebted develop- 1, in countries to balance the books, it is assumed that there will be a net decline in the reserves held by the developing countries from $33
Billion in 1982 to $18 billion in 1995. ~~
Again, given the present world economic situation, are these assumptions still valid? Extrapolating from present trends, it seems to me that an annual increase of 3.5 per cent in ODA flows will not be achieved in the next decade. If there is no drastic change in the attitude of the developed countries towards foreign assistance, such :. assistance may not increase by more than 1.5 to 2.0 per cent per “. Annum in real terms. This is the latest range of forecast by the
< OECD. A 3.5 per cent increase would imply a very large increase in .‘ ODA flows from such large donors as the Nordics, Canada and olland-on the order of 4.5 per cent to 5.0 per cent-if the attitude the major donors-the United States, Germany and Japantowards ODA does not change quite dramatically. The assumption about non-concessional flows also seems very optimistic in view of the extreme reluctance on the part of commercial banks to continue
**‘1*nding to the developing countries. In 1982, 17 heavily indebted r**
nations had a negative capital flow of $21 billion, which is equivalent to 2 per cent of their combined GNPs. The fourth assumption concerns domestic savings rates in the developing world. It is assumed that the domestic savings rates for all low-income countries will increase from about 22 per cent in the period 1960-80 to about 24 per cent during 1985-95. Such an increase translates into very high marginal savings on top of already very high average rates. Although the savings rate assumed for Africa is much lower, about 8 to 9 per cent for 1985.95, given the fact that average per capita incomes have been declining steadily in Africa, to achieve even this rate would require a herculean effort in that part of the developing world. Once again, I am rather skeptical about these projections, particularly when they relate to Africa.
Finally, there is the assumption concerning the return on investment. This is a novelty in World Development Report analysis; this is the first time that a careful analysis has been made of the return on investment in the developing countries. The Report has come to the conclusion that there is a tremendous amount of room for improvement. In fact, the Report would like to see a return on investment in the

developing countries of about 20 per cent during the decade of 1985-95. In arriving at this figure, the Report looks at a number of economic policies and economic management practices that have been adopted and followed in the past in the developing countries. An interesting bit of analysis that relates distortions in economic policies and indifferent management of the economy at all levels comes to the conclusion that some developing countries may have lost 2 per cent per annum in annual growth of GDP because of these policies and practices. A reversal in these policies, it is suggested, should add to growth in the developing countries. In my view, however, this reversal cannot take place unless it is supported by a considerable flow of resources from the outside, a point to which I will return below.

My conclusion, therefore, is that most of the assumptions that were made in order to present a scenario for the economic future of the developing countries in this year's World Development Report no longer seem plausible. The central scenario for Africa assumed rate of growth of 3.3 per cent. A rate of growth of something like 2. per cent for sub-Saharan Africa seems more plausible today, whit when combined with a population growth of 3.2 per cent, means negative growth rate of -0.7 per cent in per capita income. If there a decline in per capita income on the order of 0.7 per cent per annum in sub-Saharan Africa, how would that translate into levels of poverty?

Mahbub ul Haq and I worked on poverty estimation when we were together at the World Bank. With the help of some admittedly crude indices, we came to the conclusion that about 800 million people lived in absolute poverty in the developing countries. 1 have gone back to some of those earlier calculations to see if they can be resurrected and related to what might happen in the future. If the basis of some of our past analyses is still valid today, then at this moment there are about 900 million people living in absolute poverty in the low-income countries, out of their combined population of 2.1 billion. In South and Southeast Asia, not including China, out of a population of I billion people, the number living in absolute poverty can be estimated at about 500 million. The Chinese say that they have 100 million people living in absolute poverty. So, from the estimated 900 million, that leaves us with about 200 million people
i living in absolute poverty in sub-Saharan Africa, out of a total population of about 350 million. That is a very large proportionnearly 60 per cent of the total population.

According to some calculations I have made, whereas the subSaharan African population could increase from about 350 million in 1980 to about 550 million by 1995, the level of poverty there could increase at an even higher rate, rising to about 350 million people by 1995. What will be the consequences for sub-Saharan Africa if these z trends in population growth and incidence of poverty indeed prevail over the next decade and a half? The population would increase as 1 said by 200 million, and the number of people living in absolute poverty would increase by 150 million. This point must be under :: scored, since this would be the first time that a region as large as ?: sub-Saharan Africa would actually suffer an increase in the proper ;.. Hon of people living in absolute poverty; for the first 20 years after "? =Africa attained independence that proportion declined. '..y. To assess the kind of impact this deterioration would have, let us at what would happen to food imports. At the moment, sub=' ~" -ran Africa imports about 8.5 million tons of food. This means 5t at the region spends nearly $2 billion on food imports, as against ss billion received as concessional flows. A 2.5 per cent increase in GDP implies a very low growth rate for agriculture, which in turn m+" sdeans world imports may have to increase at the rate of about 5 to 6 a decline in per capita income on the order of 0.7 per cent per annum in sub-Saharan Africa, how would that translate into levels of poverty?

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developing countries. 1 have gone back to some of those earlier calculations to see if they can be resurrected and related to what might happen in the future. If the basis of some of our past analyses is still valid today, then at this moment there are about 900 million people living in absolute poverty in the low-income countries, out of their combined population of 2.1 billion. In South and Southeast Asia, not including China, out of a population of I billion people, the number living in absolute poverty can be estimated at about 500 million. The Chinese say that they have 100 million people living in absolute poverty. So, from the estimated 900 million, that leaves us with about 200 million people
i living in absolute poverty in sub-Saharan Africa, out of a total population of about 350 million. That is a very large proportionnearly 60 per cent of the total population.
According to some calculations I have made, whereas the subSaharan African population could increase from about 350 million in 1980 to about 550 million by 1995, the level of poverty there could increase at an even higher rate, rising to about 350 million people by 1995. What will be the consequences for sub-Saharan Africa if these z trends in population growth and incidence of poverty indeed prevail over the next decade and a half? The population would increase as 1 said by 200 million, and the number of people living in absolute poverty would increase by 150 million. This point must be under :: scored, since this would be the first time that a region as large as ?: sub-Saharan Africa would actually suffer an increase in the proper ;.. Hon of people living in absolute poverty; for the first 20 years after "?=Africa attained independence, that proportion declined.
'..y. To assess the kind of impact this deterioration would have, let us
at what would happen to food imports. At the moment, sub=' ~" -ran Africa imports about 8.5 million tons of food. This means 5t at the region spends nearly $2 billion on food imports, as against ss billion received as concessional flows. A 2.5 per cent increase in GDP implies a very low growth rate for agriculture, which in turn m+" sdeans world imports may have to increase at the rate of about 5 to 6

# CHAPTER 18
# The Gulf Area in the Current Economic Environment

**Nemir A. Kirdar**

One of the primary objectives of the Istanbul Roundtable is to analyze the dynamics of change in the context of global cooperation and international economic relations. As a private banker, I would like to focus upon the change that is taking place in the economic environment of the Arabian Gulf area. This subject is particularly relevant in this forum, since over the last ten years the Gulf States have had significant economic interaction with many parts of the world, and the changes they are undergoing will most certainly have an impact upon their relationships with countries outside the region.
The relative wealth of the Gulf States is well documented. Over the last decade their vast amounts of oil-related revenue have enabled the governments and citizens of Saudi Arabia, Kuwait, Bahrain, Qatar, United Arab Emirates and Oman to reshape their lands broadly. Among other things, they have built new towns and airports, constructed modern schools, homes and hospitals, laid new roads, installed sophisticated telecommunications systems and initiated large industrial projects. These development efforts were directed by the government

sector and financed by oil revenue. They resulted in economies which were dominated by construction and trading activity and supported heavily by foreign labor.
Several factors are combining to make the past ten years' pattern of Gulf area economic activity inappropriate as a model for the future. Some of the most important factors are the following:
(I) a lower level of income growth is expected;
(2) The level and composition of goods and services imports are changing;
(3) The level and nature of foreign labor requirements are changing;
(4) Income distribution channels are changing;
~'%' (S) a continuing shift from domestic to foreign investment is anticipated; and
- (6) the private sector is expected to have a somewhat greater role in future Gulf area economies.
Evaluation of these six factors will provide some insight into the effect the changes will have on the outside world.
The first factor, a lower level of income growth, is a function of reduced oil revenues. Although massive oil reserves have enabled unparalleled development and accumulation of wealth, the. Constantly increasing streams of oil-related revenue are known today to be a thing of the past. The oil glut and concomitant fall in oil prices have highlighted the volatility of oil revenue and have demonstrated that unlimited amounts of oil money will not be available to sustain Gulf economies forever. The combined government oil revenues of Saudi Arabia, Kuwait, the UAE and Oman peaked in 1981 at $135 billion. The 1983 revenue estimate is $68 billion and the annual projection for the next four years will remain below the 1981 record, perhaps reaching $126 billion in 1986. The erosion of the real value of oil revenue will be even greater than the decline in nominal value. The estimated 1986 value of nominal revenues is about 94 per cent of their 1981 level, whereas in real terms it will be only 72 per cent.
The second factor bringing about change in the Gulf economic environment is the changing level and composition of goods and services imports. After many years of intensive construction, most of the Gulf states have put in place the essential elements of their basic infrastructure, e.g., roads, ports and airfields, communications, schools, and hospitals. Moreover, many of their large-scale industrial projects should be fully operational within the next two or three years. These developments will have the effect of shifting the main thrust of regional growth from construction to industrialization, with the not inconsequential side effect of significantly changing the commodity mix of imports. New regional industries such as petrochemicals, iron and steel mills, aluminum smelters, cement and fertilizer factories will begin manufacturing products which, in one fashion or another, will displace previously imported items. Imports of intermediate goods, e.g., raw materials, as well as machinery and equipment, are likely to remain strong.
At the same time, the substantial deceleration in construction activity, brought about by the diminishing rate of infrastructure development, will result in a major reduction in the import of construction-related goods and services. Non-oil economic activity will remain heavily dependent upon oil-financed spending until some of the major industrial projects begin production. The annual real growth rates of the 1979-80 non-oil GDP for the area as a whole were
9 to 10 per cent. When this performance is compared with an estimated 3 or 4 per cent real growth rate for the 1983-85 period and an estimated 5 per cent after that, the extent of the deceleration can be seen.
The third factor bringing about change is the level and nature of foreign labor. There is little doubt that the economic slowdown will have a profound effect on the labor needs of the region. Foreign laborers (and their families) account for approximately 44 per cent of the region's population of over 12 million. Most of these foreign workers are unskilled construction workers. It is estimated that, due to

the shift away from construction-dominated economies, 400,000
I foreign residents (7 per cent of the foreign population or 3 per cent
r of the total population) will have left the region by the end of 1983, and that as many as 500,000 will have left by the end of 1984. Even assuming a 3 per cent natural growth rate for the indigenous
." population, the total population, after these changes, would be 1 per
'. ant less than it was in 1982. Given that the total population growth
s rate in the region over the past four years has been 8 to 9 per cent annually, this is a radical demographic change with important implications.
One of the most important of these implications is a general (. reduction in consumer demand. A population change of this magna; tude will mean a $1.2 billion reduction in annually imported con?:r turner goods and savings of $2 billion in annual transfer payments. A (u'tecond implication is a probable softening of any socio-cultural tensions that may exist because of the high foreign labor content in
. the Gulf states. A third implication is that the composition of foreign *, tabor will shift from predominantly unskilled construction workers >: 'tb a more skilled group of industrial and other production workers. + The fourth factor which is affecting the future Gulf economic torments is a change in income distribution channels. One of the fladitional ways in which the Gulf governments have transferred oil -•to to the private sector is by channeling the sale of consumer and services to expatriate laborers and other consumers i 1h the private sector. Gulf governments have also given billions „. • lets worth of construction contracts to local private firms. traditional channels of income distribution will be affected
., ntly by the reduction in construction activity and the exodus : "; 'gn laborers. Many local businesses rely entirely upon con work or expatriate customers for their existence. Thus. Adjustments will be required.
The fifth factor is the continuing shift from domestic to foreign investment. This shift is already in progress and is expected to continue at a gradual rate over the next several years. Foreign -. Investment will eventually dominate domestic investment for several. Reasons. Firstly, foreign investment will remain an important income alternative to declining oil revenues. Kuwait, for example, generates about $8 billion in annual investment income, about equal to its income from petroleum sales. Secondly, domestic investment opportunities are insufficient to absorb the vast amount of government sector and private sector funds available for investment. Thirdly, the process of industrialization will create a need for further transfer of foreign technology which can, in part, be accomplished by increased investment in Western industrial and commercial companies.
The sixth factor which is expected to influence the future environment of the Gulf economies is the increased participation of the -; private sector. The government sector has been responsible for the large-scale development of infrastructure and the petroleum industry, Its involvement has been necessary because of the capital costs related to the development of both, and because neither, in the Gulfs context, lend themselves to private sector ownership and development. That is not to say that Gulf governments are not in favor of private sector development. Indeed, they have invested substantially in a multitude of programs designed to create flourishing, free enterprise economies which they hope will be capable of sustaining wealth long after oil runs out. Now, as infrastructure and the petroleum industry development achieve a mature status, the private sector will be expected to play an increasingly important role in the continuing economic development of most Gulf countries. The impact of these six factors on the economic environment of the Gulf area will be substantial and will be felt outside the area as well as within it. Oil prices rose by 1,200 per cent during the 1970s. The income of the Arab producers rose from $45 billion in 1970 to $204 billion in 1980. Construction spending accounted for more than 10 per cent of - GOP throughout the decade. This percentage is much larger when
one includes investment in manufacturing, mining, health, education,' .. electricity, water, transport and communications. For example, invest meet in these areas

during the years 1973-78 was growing at a rate of 30 per cent per year in Saudi Arabia. There was, therefore, much spending on the infrastructure necessary to support a modern and ultimately non-oil-based economy. There was also spending on industrialization. However the frantic pace of development in both areas could not last. Now that the initial momentum of infrastructure investment is behind us, and given the decline in oil revenues, the heady expenditure and growth of the 1970s are also past. The Gulf market is an immense one, even in construction, but the future economic environment of the area will be altered irrevocably as a result of the changes that are now in progress.

# PART V
# HUMAN RESOURCE DEVELOPMENT

"No country can be regarded as having achieved self sustained growth until it possesses the required technical skills and administrative and managerial structures to keep the development process going."
• Bradford Morse

## CHAPTER 19 An Overview*

**Uner Kirdar**

In the workshop on Human Resource Development, the participants focused mainly on: (a) the positive effects of human resource development in social development and economic growth; (b) the importance of skill formation in developing countries for creating a self-reliant capacity to achieve development objectives; and (c) the severe political and human costs accruing from the neglect of human resource development. The participants examined the efforts made at both national and international levels to build human resources, studied the relationship of human resource development to capital investments and other aspects of economic growth, and in the light of their analysis suggested several measures to be effected immediately at all levels.

### LESSONS FROM THE PAST

In the 1950s and 1960s, the development dialogue and negotiations in which the international community engaged were primarily based on the belief that successful growth could best be ensured through a massive transfer of capital resources from developed to developing countries. This view stemmed from the positive results of the Marshall Plan. It was not fully appreciated that the achievements of the Marshall Plan were made possible because the recipient European countries had the human and institutional capacity and capability to sustain, maintain and maximize the investments made in them.

In the 1970s, while recognizing the continuing need for sustained capital assistance, the international community highlighted the importance of better terms of trade and increased trade flows from developing countries. And in the current decade, monetary aspects of the development process have gained prominence and have been added to the development formula. These three elements, while highly relevant to the process, are means to achieve development and not themselves the objectives of development. The international community, in its fervent search for economic recovery, for financial,
trade and monetary restructuring and for appropriate institutional responses, has frequently forgotten that individual people are at the core of all development efforts. Discussions on the state of the world economy tend to focus almost exclusively on trade, monetary and financial matters. Such issues as the quality and level of skills in public and private sectors, productivity, knowledge, process improvement, labor/management cooperation, community participation, the capacity to respond to changing needs and cultural aspects of growth have been regarded as "soft" elements and have not received the proper attention.

## THE NEED FOR BETTER MANAGEMENT OF HUMAN CAPITAL

The participants agreed that although capital is essential, it is certainly not the only critical factor needed to transform a society into a productive and advanced one. Improving the management and efficiency in the use of capital investments is equally important. The nonmaterial sources of growth, such as know-how and technological skills, contribute to and directly affect the rate of growth. Success in the development process, therefore, depends to a large degree on developing the necessary human capital and the capacity for institution building and economic management.

In light of current restraints on economic growth, careful planning for human resource development becomes even more significant. With shrinking external resource flows, priorities need to be reevaluated, and better management of economies is required. All this entails the effective use of human resources. Indeed, it can be argued that even under present conditions of economic stagnation, economic growth at a reasonably acceptable rate can be sustained in most developing countries if a proper emphasis is placed on human resource development and on better management policies.

The lack of adequate trained manpower-a principal constraint on economic and social development-is seen not only in developing countries, but also in some industrialized ones which have to cope with adjustment problems resulting from structural changes needed in the agricultural and manufacturing sectors. Thus, the management capacity of a society to create necessary adjustment mechanisms for a changing economic environment determines its political and social resilience.

## ROLE OF OFFICIAL DEVELOPMENT ASSISTANCE IN HUMAN RESOURCE BUILDING

International technical cooperation for human resource building has an essential role to play in the development process of developing countries. However, the international community has given little consideration to the proper proportion and linkage between technical assistance and capital transfer. Despite evidence showing the importance of human resource development, data of relevant multilateral development agencies indicate that technical assistance now represents at most 20 per cent of all ODA, an actual decline from a few years ago. In contrast, developing countries themselves devote on the average nearly 40 per cent of all

their development expenditures to human capital formation.

## IMPROVING THE QUALITY OF HUMAN RESOURCE BUILDING

The quality of programs of human resource development is of extreme importance, especially in view of the current scarcity of international resources. The technology and know-how to be transferred from industrialized countries need to be appropriate to the absorptive capacity of the country concerned and geared to the objectives of national development policies. International technical cooperation efforts ought to give greater attention to national institution-building and the reinforcement of local initiatives, in harmony with national aspirations and to enhance self-reliance. Teaching and training systems need to be developed in such a manner as to provide the most practical education and create productive skills.

Furthermore, recent upheavals in the world economy have made apparent the need to build developing countries' management capacity in the areas of international trade, finance and debt negotiations. Concerned international organizations have a special responsibility to assist developing countries in strengthening their skills, bargaining capabilities and knowledge in these domains.

Human resource development is strongly related to the financial and debt situation. When foreign exchange is available and economies can develop quickly, human resource development reaches the poor as well as the rich. When there is stagnation in the economy, however, those who are wealthy and powerful manage to hold on to their gains and, in some cases, even increase them in order to offset perceived risks. The poor become poorer, not only relatively, but absolutely. And under such conditions, human resource development is assigned a lower priority, for two reasons: first, political leaders tend to respect those groups which are politically and economically powerful (and disadvantaged nursing mothers and infants are not among the ranks of the powerful); and second, human resource development in the short run creates a demand for imports, necessitating foreign exchange, whereas foreign exchange savings and earnings can only be produced in the long run. It is easier to teach people consumption patterns than production methods.

Human resource development is also closely linked to the incentive system and physical capital formation. It is not enough just to provide an effective educational system; there must be a system of price incentives to ensure that the knowledge is utilized. And the financial and capital resources—the raw materials, equipment, etc.to put the knowledge into operation in an effective manner must also be present.

## COUNTRY EXPERIENCES

Since substantial differences exist among the developing countries in terms of their structures and level of development, no single fixed ratio of technical to capital assistance is appropriate. Each case must be studied individually. In this context, countries can be divided into three categories: those possessing rich natural resources and/or physical capital; those which do not have these resources but have developed human capital; and those which possess none of these resources.

The majority of the Arabian Gulf countries, belonging to the first category, saw a large influx of capital beginning in 1973, and as a result, development efforts were launched. These efforts, however, required trained manpower, which was not available locally and had to be imported from abroad. The users, lacking the proper skills, were unable to sustain the development. This experience shows that capital resources alone are not sufficient for development. These countries have now recognized the need for better internal management and have begun to develop training programs to provide their people with practical vocational skills.

Other countries, such as Turkey, Pakistan and Brazil, require the proper manpower to exploit fully their rich natural resources. It is important that they gear their educational programs to meet national development priorities.
In the second category, those countries with sizeable populations, such as South Korea and Taiwan, have tailored their educational systems to create an export-oriented economy, which then attracted capital for investment. Smaller countries, such as Singapore and Bahrain, the only Arabian Gulf state without oil, have built the necessary infrastructures to become regional banking, financing and trade centers. The experience of these countries demonstrates the impact of human resource development on the overall development process.
Finally there is the special case of sub-Saharan Africa, which has attracted a great deal of attention in recent international bra. For these countries, it appears that one cannot ensure economic growth simply by means of better domestic economic management. Here the first priority of the international community is to reduce the number of people living in absolute poverty which, based on current projections of the region's rates of growth of population and economy, may actually increase in the coming years. The only feasible means of ensuring economic growth for sub-Saharan Africa is to allow for a much larger flow of ODA to that region, directed at the elimination of poverty and the concomitant development of human resources for better economic management.

## ROLE OF THE WORLD BANK AND THE INTERNATIONAL MONETARY FUND

Only a few years have passed since the World Bank adopted a more flexible and progressive approach in its lending activities. Poverty alleviation, education, health, rural development, vocational training, etc. became fields for bankable projects. Soft loans have been granted for technical cooperation and human resource building. Thus, the Bank recognized the importance of improving the quality of life for development and the significance of human resource building and skill formation, in order to protect, maintain, support and promote the investments made. As a result of this new approach,
• nearly one-third of the Bank's lending was directed until recently to '.Increasing the productivity of the absolute poor, improving the state afeducation and health, etc. Similarly, the Bank provided an annual 'global balance sheet on poverty. Unfortunately, there are now signs
'that the World Bank is retreating from these important undertakings.
With regard to the International Monetary Fund, it appears that the impact of its conditionality could inhibit the process of human capital formation in developing_ countries and, in so doing, damage growth and prevent the emergence of a self-reliant capacity for further development. Deflation in government expenditures is normally the main feature of the adjustment packages worked out by the IMF for debtor countries in financial difficulties. In most of the recent cases, such adjustment measures have led to substantial cuts in real wages and social expenditures in the borrowing countries. Serious hardships ensue, particularly for low-income groups where the margin for survival is quite small. While these cuts involve major human and social costs, they often do not bring about the necessary adjustment; instead, they create a climate for eventual political and social turmoil. In the present period of recession, an important question to be answered is how to protect the efforts for human capital formation from the reduction and erosion of lenders' confidence and from the social and political costs of IMF conditionality. A strategy should be devised, combining both short- and long-term elements, to insulate human resource development from the negative influences of the upheavals in the monetary system, and to ensure that the available resources be maximized. Such a strategy would need to take into account the close relationship between human capital, financial capital and the incentive system, focus on action at both the international and national

levels, and involve the public and private sectors. Formulation of such a strategy should be under girded by a systematic analysis of the experiences of a number of countries and their respective development approaches. It is not possible, however, to devise a human resource development strategy of universal applicability. Instead, the contents of such a strategy could be determined by the individual situation of each country and its specific skill requirements.

## THE ROLE OF THE UNDP

The United Nations Development Programme, the central funding organization of the United Nations system in the field of technical cooperation, has played a unique role to date in promoting human resource development. The principle of universality underlies all its policies and practices vis-a-vis both donors and beneficiaries. More than 140 developing countries, at different levels of growth, have benefited from assistance rendered by this organization on a grant basis, and have also contributed to its financing. The UNDP has also held fast to the principle that developing countries themselves should establish their own development priorities. In recent years, however, there has been a growing tendency on the part of some donor countries to wish to target UNDP assistance to what they consider the priority needs of developing countries to be. Likewise, in view of the critical resource constraints facing the UNDP, there has been a similar desire to graduate middle-income and newly industrialized developing countries from their status as beneficiaries of assistance from the Programmed. These trends are extremely serious since they mark a retreat from the guiding principles of the UNDP. Full recognition must be accorded to the need for developing countries to establish their own development priorities in order to maximize the integration of various sources of external assistance into national development programs and to ensure the fullest impact of such assistance. This is particularly crucial in times of scarce resources. And middle-income countries should not be graduated from UNDP assistance. These countries require human resource building, technical know-how and the transfer of technology perhaps more now than ever before, since they are in the early stages of industrialization. Their requirements for technical cooperation are thus becoming more complex. Should these countries be deprived of UNDP assistance, the gap between levels of investment for human and physical capital formation would widen? One means of safeguarding the universal character of the UNDP and of making assistance available to middle-income and newly industrialized developing countries would be to provide such assistance on a reimbursable basis. This means of financing, by creating a revolving fund in the UNDP, would also help the Programmed to accumulate additional resources on a more predictable, continuous and assured basis.

## PRIVATE SECTOR

The private sector has an important role to play in the development of human resources, through on-the-job and formal training programs. By these means it can improve skills, increase productivity and provide managerial know-how and technical knowledge. Most of the required modern technology and management tools are found at present in the hands of private enterprises of developed countries. Multilateral technical cooperation has been traditionally provided only through governments to the public sectors of developing countries. There is a need, therefore, for an international mechanism to channel the technical resources and expertise of the private sector of industrialized countries to the public and private sectors of developing countries.

## PROPOSALS FOR ACTION

In light of their discussions on human resource development issues, the workshop participants formulated a series of measures to be taken both at national and international levels, in order to assist the promotion of human resource building.

Action at the national level Increased sensitivity to the crucial importance of human resource development is needed among policy makers and government bureaucrats in industrialized countries, so that they will support it accordingly. A similar consciousness-raising process is required for developing countries. Particular attention should be paid in developing countries to the establishment of a creative educational system, structured to meet prospective needs of a country's economy, avoiding both over qualification and structural skill deficiencies in the available human resources. It is essential that an appropriate balance between different levels of education be struck, in order to allow the emergence of as wide a talent base as possible. Care should also be taken to integrate women fully into the educational and human resource development process; otherwise, 50 per cent of a country's human capital would remain untapped. And programs and educational systems should benefit all ethnic and religious segments of a country's population. Developing countries should encourage independent creative efforts at the grass roots level, leading to the formation of appropriate institutions and the acquisition of managerial abilities. Autodidactic training and management approaches could play a role.

Action at the international level

- Higher priority should be given to human resource building in the development process, especially in relation to capital assistance.
- ODA flows should be increased, and a growing share of ODA should be earmarked for human resource development, commensurate with the proportion that developing countries themselves devote in their budgets for that purpose, to meet the increasing needs for human and institutional resources. Multilateral technical cooperation inputs should be doubled over a five-year period to supplement growing capital assistance.
- Closer linkage should be made between technical cooperation and capital assistance, and a broader cooperation between multilateral agencies dealing with technical assistance and that providing capital assistance should be pursued.
- There is a need for an annual report on the state of human resource development as a counterpart to the World Development Reports and the World Economic Outlooks. This report should take stock of the year's reverses and progress, review various countries' experiences, provide different paradigms of human development and demonstrate the results of IMP conditionality and other policies in terms of human 2nd social costs.
- The World Bank should increase the total proportion of its landings in support of improved human living conditions, with appropriate reporting thereon in the annual World Development Report. The World Bank should reconsider its policy of giving high interest loans for human resource development programs, as they may aggravate the indebtedness of developing countries.
- The UNDP should be provided with adequate resources on a more predictable basis. Existing domains and procedures for multilateral technical cooperation should be reviewed, to keep them in step with changing needs of developing countries.
- IMF conditionality should be linked not only to monetary and financial measures but also to specified levels of output and employment and to a set of physical-quality-of-life indicators on which adjustments should be based.
- Developing countries should intensify cooperation within regions and among like-minded countries, as an alternative to accepting conditionality.

## CHAPTER 20

**Human Resource Development: Challenge for the '80s**
**Bradford Morse and Uner Kirdar**

The early 19805 were not good years for the world economy nor for the international development effort. World economic growth slowed markedly, affecting all regions and most countries, regardless of their size, stage of development or economic status. Around the globe, gross domestic product per capita fell significantly, resulting in the longest and deepest recession of the last three decades. A sizeable number of developed and developing countries experienced actual declines in their gross domestic product. The volume of international trade, which was a main factor in economic growth in the 1960s and 1970x, declined by over 1 per cent in 1982, after a period of virtually no growth in 1980 and 1981. Rates of unemployment were abnormally high, and this heightened po'Rtical pressures in both large and small industrialized countries for protectionist measures and trade barriers. International financial markets experienced unprecedented turbulence. In 1981, with rising unemployment, declining trade prospects and increasing budgetary constraints, developed countries curbed their multilateral assistance to developing countries. These events, subjecting the international economic structure to unprecedented pressures, exposed the fundamental lack of security obtaining in international economic relations.
Developing countries suffered most from this economic upheaval. During their remarkable performance in the mid-1970s, most of these countries had proven that they possess the capacity to use modern technology, organize efficient production, penetrate international markets and. meet their external debt obligations in normal circumstances. In the early 19805, however, they had to fight the combined effects of worldwide recession, declining world trade, depressed commodity and escalating energy prices, increased protec tionist measures imposed on their exports, a low level of official development assistance (ODA) flows and reduced loans from commercial banks, and formidable financial constraints stemming from a surge in debt-servicing requirements. The least developed among the developing countries, with few reserves and resources to combat the downward spiral, were the hardest hit.
The outlook for the near future is also bleak. Even if a mild recovery occurs in the main industrialized countries, a number of forces are at work which may continue to restrain growth in developing countries. In fact, a further decline in per capita output appears to be in store this year for developing countries as a whole and for a number of individual countries as well.' The extremely difficult financial situations faced by newly industrialized countries and the recent substantial declines in the revenues of oil-exporting developing countries may force both groups to make major reductions in spending for development as well as sharp cutbacks in their imports from industrialized countries. This, in turn, may aggravate further the present high rate of unemployment in industrialized countries and accentuate international recession. As it is, persistent budget deficits in developed countries and falling export earnings in OPEC countries leave little room for increasing the flows of official development assistance (ODA), particularly in real terms.
There are two main sources of growth in the development process. One is an increase in the quantity of capital and labor. The other is an improvement in the quality, efficiency and use of these inputs. The non-material factors of human resource development-know-how, technological and managerial skills, etc.-directly contribute to the rate of economic growth. No country can be regarded as having achieved self-sustained growth until it possesses in both public and private sectors the required technical skills and administrative and managerial structures to keep the development process going. Unfortunately, in many developing countries, not only is the capital formation ratio low, but also the base of human skills is

desperately weak. Of course, in some developing countries, basic organizational and technical skills are either not in critically short supply or are financially obtainable. But an extreme weakness in human resources can be found in almost all of the poorer developing countries and, paradoxically, in some of the richer developing countries as well.

The first years of this decade were hard years for the hundreds of millions of people who depend on development for a better life. They were also difficult for the development process itself and for the institutions which support this process. As an example, the United Nations Development Programme (UNDP)-one of the most important instruments of multilateral cooperation-has had to struggle, like the developing countries it serves, against the negative trends of these years.

The UNDP provides assistance to developing countries in two separate, but closely related areas: (a) technical cooperation and (b) pre-investment. Its contribution, though numerically modest, is of key significance since it has a multiplier effect on the aggregate flow of funds. It helps expand this flow by enhancing absorptive capacity for investment, through human resource building, feasibility studies and project preparation. Of even greater importance in the long run is the contribution which UNDP makes in assisting developing countries to become self-reliant. During the decade of the 1970x, the resources available to UNDP grew from about $250 million to nearly $800 million. In 1981, however, for the first time in UNDP history, contributions actually declined by 6 per cent in nominal terms and of course substantially more in real terms. In 1982, they barely advanced over that disappointing result. For that year, in contrast to target expenditures (indicative planning figures (IPFs)) of $750 million, set for the first year of the third development cooperation cycle (1982-1986), UNDP had available to it only $568 million in 1PF resources for the delivery of its field program. This was a shortfall of almost $200 million against the target.

## WHAT THE RECORD SHOWS

For thirty years or more, an increasingly effective development effort has brought about a direct and manifold improvement in the human condition unprecedented in the annals of human history. Yet by the early 1980s the effort showed signs of faltering. The development gains of three decades now appear at risk. After so much experience and progress, it is surely worth asking whether international cooperation for development may have lost its bearings, and how. We must consider the lessons of the past efforts, so as better to assess future prospects.

The first lesson, on which by now there is broad agreement, is that development generally has been a remarkable success. Since the dawn of history, the common lot of most of humankind has been little different from that described by the philosopher Thomas Hobbes in 1651: “solitary, poor, nasty, brutish and short.” In the last 30 years, however, even in the world’s poorest countries, a revolutionary change has taken place. In most parts of the world, rampant disease and hunger are being fought vigorously. For much of humankind, illiteracy has been vanquished. There has been a steady improvement in the human condition. The record of three short decades is a triumph of history, due in substantial measure to an unprecedented international cooperative effort. According to the famous British historian, Sir Arnold Toynbee, future generations may see as this century’s biggest achievement not its unprecedented scientific discoveries, but its realization, for the first time in human history, that man’s knowledge can be shared all over the world for the common good. The figures speak for themselves. From 1950 to 1980 the share of developing countries in world industrial output rose from 5 per cent to 20 per cent. Developing countries as a group increased their gross domestic product fivefold, their industrial output tenfold, their gross capital formation almost twelvefold, their skill formation (based on the number of college and technical degrees awarded) sixteenfold. These are measures of performance far in excess of those recorded in the same period for the industrialized

countries. Indeed, developing countries have substantially bettered the performance of today's developed market economies during their formative period of technological transformation, including that of Japan during its main period of growth and modernization from 1910 to 1935. Structural changes in developing country economies have been particularly significant. Farm production has grown faster in developing countries than in developed countries over the last 30 years and, on a per capita basis, is 25 per cent higher today than in 1950. The share of imports of manufactured consumer goods has fallen over the period, and that of machinery and transport equipment (capital goods) has grown. Over and above the twelvefold increase in capital formation, investment in education, health, social welfare and essential social services-i.e., in social technologies-has risen from less than 3 per cent of national output in 1950 to 10 per cent in 1980 and now equals nearly two-fifths of the resources currently devoted to capital formation. Even in terms of self-reliance, developing countries have made enormous strides, with modest international assistance. In 1950, there was scarcely a developing country with a development plan or program of its own design. Today national, regional and even sectoral planning is accepted throughout the developing world as an effective instrument of self-reliant advancement. Yet progress has been uneven. The poorest countries, in particular, have lagged. Output per capita fell during the 1970s in IS countries of sub-Saharan Africa. For nearly half a billion people worldwide who still know the ravages of hunger and malnutrition, the suffering and fear are no less intense than they were thirty, two hundred or a thousand years ago. But the miraculous turnaround in the basic - human condition is undoubtedly the greatest untold story of our times. Development has worked in ways many of us did not dream. The last 30 years have seen almost 100 new countries join the world economy as increasingly important participants. Over the last decade, a dozen of those countries-the so-called Nicks or newly industrialized countries in Latin America and Asia-have captured increasing shares of world markets, while rapidly expanding their agricultural and industrial output. South-South trade now accounts for more than 7 per cent of world trade (and a quarter of the South's exports). Developing countries have increased their share of trade in manufactured exports to developed countries from 3 per cent in 1950 to 13 per cent in 1980. The impact of these achievements has been rewarding and remarkable. But they can be eroded quickly. If, just when steady growth has become possible, the flow of resources required to sustain it is cut short, the sudden flagging of development may bring despair, frustration, and anger on a scale not seen before. Credit for the past sustained accomplishments must above all go to the developing countries themselves. They have marshaled the overwhelming proportion of the human and material investments required for progress. As economist Theodore W. Schultz has put it, "the achievements of many low-income countries in their private and public investments in human capital are indeed impressive given their resource constraints."' Official development assistance has served as a catalyst, initially, in the years following World War It. the emphasis was on technical assistance-or the transfer of basic skills and technologies-as exemplified by the large increase in bilateral aid and the establishment of the UNDP predecessor organization, the Expanded Programmed of Technical Assistance, in 1949. Emphasis later shifted toward capital assistance designed to help developing countries 2Theodore W. Schultz, investing to People.' the Economics of Populativi Qualify (Berkeley: Univ, of California Press, 19S1), p. 142. strengthen their physical infrastructures. Later still, food aid, humanitarian assistance and, most recently, adjustment assistance became important features of the ODA effort, as has the rapidly growing assistance provided by non-governmental organizations. The twelve fold growth in capital formation experienced by developing countries as a group since 1950 is a solid indicator of the self-help efforts of these countries and the broad effectiveness of ODA capital development inputs over the period. Lending for these capital inputs, predominantly financed by ODA or related flows in the 1960s and early 1970s, was supplemented by the mid-1970s

by private lending, which has since become the predominant source. Undoubtedly, the surge of "petrodollars" played a role in this shift. In any case, by 1982, 60 per cent of total lending to developing countries was on commercial terms, a fact which demonstrates the effectiveness of the foundation for investment laid by the efforts of developing countries and ODA together. These results would not have been achieved without effective and lasting human resource development. Experience acquired during the last 30 years of capital assistance, however, proves that the transfer of financial resources for investment purposes is not a sufficient condition for achieving development. Success depends primarily on developing the necessary human resources and the capacity for institution building and economic management. While the supply of capital may vary and equipment become obsolete, the basic technical knowledge and skills possessed by human beings endure and multiply. Improving the conditions of these essential factors of economic growth is a prime objective of technical cooperation. It is more difficult to quantify the impact of technical cooperation than that of capital assistance, for the effect of technical cooperation is more pervasive yet less visible and less easily aggregated in statistical terms. Nonetheless, without the enormous progress made in human resource development over the past three decades, it would have been impossible for developing countries to sustain and maintain capital investment, or to strengthen their essential human and institutional infrastructures. The following figures provide compelling evidence of the massive efforts made by developing countries in the human equation and of the catalytic contribution made by technical cooperation.

About a third of adults in developing countries were literate in 1950. Three decades later, the proportion had advanced to 56 per cent. The advance in literacy rates was even more pronounced for low-income developing countries, where human resource development played a particularly important role. In 1950 only 20 per cent of adults in these countries could read or write; by 1980, 50 per cent could-a gain of 150 per cent.

- Advances in life expectancy and declines in child mortality tell a similar story in terms of improved health. Between 1950 and 1980, life expectancy for developing countries as a group rose from 43 to 58 years, with the figure for low-income countries advancing from 41 to 57 years.
- Child mortality in developing countries declined in the same period from 28 per thousand children aged one to four years in 1950 to 12 per thousand by 1980.
- Skill formation in developing countries grew impressively over the three-decade period. Resources devoted to research and development (R&D) increased from a negligible base in the early 1950s to nearly 0.5 per cent of gross domestic product (GDP) by the late 1970s (compared to about 2 per cent for developed market economies). Although developing countries still only accounted for about 3 per cent of worldwide R&D expenditure, they provided 12 per cent of its global manpower.
- Primary school enrollment in developing countries increased sharply from 56 per cent in 1960 to 78 per cent in 1978. Secondary schools showed an even greater increase, in which the number of students as a percentage of their age group tripled.
- Enrollment in universities and institutions of higher learning rose by more than 10 per cent yearly, to a current level some 16 times that of 1950.

The World Bank's World Development Report for 1982 sums up the effect of technical cooperation thus:

Although growth requires an increase in the primary factors used in production, improvements in the efficiency of their use have been responsible for most of the growth in developing countries.... By broadening domestic technical and managerial skills, changing the
attitude of farmers and workers, and, it is hoped, lowering the birth rate, human development offers the prospect that per capita living standards can be improved faster in the 1980s. This long-term improvement in human capital is the one bright spot that is

shared by almost all developing countries?

## PROGRESS AT RISK

Why should this great development enterprise show signs of stalling in the 1980s? Why should it be perceived as posing a threat to the world economy or to the economic recovery of any industrialized country? Why should development assistance not be regarded as an important element in the recovery of the global economy? As always, the reasons are many and complex. Continuing recession in the industrialized countries, which has prompted an effort to reduce public expenditures and heightened the threat of protectionist measures, is certainly a factor. The developing countries' adverse terms of trade, their depressed export volumes, the high and volatile interest rates limiting their borrowing, and their large debt repayment burdens are additional factors. The problem was dramatized in 1982, as combined developing country debt rose to the level of $630 billion. The OECD/ DAC review for 1982 notes that "towering deficits, both fiscal and current account, in most countries have reached or neared financial limits imposed by high cost and more selective financial markets, limited access to concessional aid, and slumping exports. Painful adjustment has been, and in most countries continues to be, unavoidable."° In April 1982, the Managing Director of the International Monetary Fund (IMF) warned that "the external deficits of the developing countries have reached record levels. Of those that are net importers of oil, half now face current account deficits of 12 per cent of gross domestic product or more-about three times their [3]World Development Report 1981 (New York: Oxford University Press, 1982), published for the World Bank, p. 2.^Development Co-operation: Efforts and Policies of the Members of the Development Assistance Committee, report by Rutherford M. Poets (Organization for Economic Co-operation and Development, November 1982), p. 12.
level of a decade ago. Deficits of this magnitude clearly cannot be sustained in terms of future debt service capacity."[5] Similarly, the recent follow-up report of the Brands Commission points to the havoc wrought by falling export earnings, oil prices and high interest rates in the economies of developing countries over the last three years. The report notes that:
In the five years 1976-81 total debt grew by 20 per cent a year (it was $251 billion in 1976). But the part owed to banks grew by 25 per cent a year, and the short-term part grew fastest of all, 29 per cent a year. In the early 1980s the combination of rocketing interest rates and bunching of maturities has put a number of countries into a position of very high obligations. They can pay them from net foreign earnings or by drawing down reserves. But developing country reserves have fallen rapidly. And in trade they have had net deficits, not net earnings. The only way they can meet their debt obligations is by borrowing more P The strain on world financial markets is now the subject of widespread concern. In this respect even concessional lending institutions providing capital assistance are being forced to adjust their policies to meet more immediate developing country needs. In fact, the effect of debt obligations on rates of return for capital investments may only now be surfacing, as the accumulated impact of inflation, lower export earnings and depressed commodity prices begin to take their toll. Yet there is another fundamental, persistent handicap threatening rates of return on capital lending-the inadequacy of existing human and institutional infrastructures to support such lending on a practical basis.

## LEARNING LESSONS FROM THE PAST

Drawing the relevant lessons of successful and unsuccessful development

cooperation experience in diverse circumstances is the first step toward improving both the processes of development and the administration of aid. Such experience suggests that what is required is a better balance in the development effort as a whole and particularly in two broad, critical areas: (a) at the global level, where the implementation of new, more just and equitable international economic arrangements would enable more rapid progress for the entire world community; and (b) in the provision of external assistance, where a better mix of technical and capital inputs has become a matter of great concern.

Concentration on capital investment in the development process, essential as it is, has obscured the relative importance of other factors necessary for sustained growth and self-reliance-management, quality, knowledge, process improvement, training, labor/management cooperation, community participation, and cultural considerations. These are mostly intangible factors, no easier to quantify than the diverse results of technical cooperation itself. Econometric models tend to omit such "soft" factors, even though these may make or break a development effort at any stage. Their omission is one reason why econometric forecasts so often fail to prove accurate and why productivity measures become a puzzle in their context. It is as though the concepts inherited from the industrial revolution-long production runs, greater volume, economies of scale, standardization, specialization and labor-saving trade-offs-were fit guides for developing country progress in the 1980s, despite all we have learned since and despite the experience of the newly industrialized countries (NICs). Surely this approach underrates the many lessons and experiences available from a worldwide effort which by now has so many accomplishments to its credit. In this time of general international economic distress, we cannot afford to disregard the unmistakable lessons of the past, some of which are considered hereupon.

Rectification of present anomalies

That the present situation is anomalous is made evident in the 1982 DAC review of the lessons to be drawn from the favorable development experience of middle-income countries:

"Development takes time, but much time has been wasted in all countries by false starts, uneconomic investments, inconsistent or disjointed programs, and neglect of fundamentals; such waste is not inevitable."

"The fundamental resource requirement is an adequate supply of literate, trained and motivated manpower for essential functions; training and motivation can be achieved most efficiently in close association with the development or technical upgrading of actual operations."

"The fundamental development policies are those which unshackle and activate the material aspirations and energies offarmers and businessmen."

"Development assistance makes its strongest contribution when aid is coordinated in the context of a continuing policy dialogue and targeted on obstacles to the achievement of primary development objectives."

The same report refers as well to "the seemingly anomalous situation" of UNDP, noting that "the faster growth of the IEIs (international financial institutions) created an imbalance between financial and technical cooperation, and this gave rise to a situation ..- in which the IEIs themselves had to expand their technical cooperation activities."s Total World Bank spending on the technical assistance components of its loans has risen from less than $100 million in 1970 to $1,469 million in 1982. This compares with total loan commitments by the Bank in 1982 of $13,016 million, and so was roughly 11 per cent of the Bank's total lending in the year.[9]

Experience, existing knowledge and even official doctrine now dictate what needs to be done. The International Development Strategy for the 1980s, as endorsed by the General Assembly in resolution 35156, declares: "Realization of the goals and objectives of the new International Development Strategy will ... require a renewed emphasis upon technical cooperation and a significant increase in the resources provided for this purpose.'"[0] The UNDP resource planning target

for technical cooperation, for example, as adopted by consensus of its Governing Council, would be roughly double (in nominal terms) over the course of the Programmer's third development cooperation cycle (1982-1986). At three consecutive sessions, the Council has endorsed that target, and three times the General Assembly has endorsed the Council's decisions. But the growth has not come. In 1982 UNDP had resources sufficient only to deliver a volume of technical cooperation which in real terms was lower than a decade earlier in 1973. That is one reason the Srandt Commission, in its recent follow-up report, warned that United Nations aid channels were being "starved" and that the United Nations Development Programme has been particularly hard hit. The Commission called upon the donor community "to restore the funding of these agencies on an adequate basis."

**A Higher Ratio of Technical Cooperation in ODA**

Since the early 1950s, the dialogue between the developed and the developing countries has largely emphasized economic and financial gaps and, especially, the means for increasing the flow of ODA. Little consideration has been given to whether or not OVA has contained a sufficient proportion of technical cooperation, as compared to capital transfers. The latter must, of course, remain a central concern, but it is also essential to highlight more systematically the role of technical assistance as a source of development. Human capital-the availability and efficient utilization of skilled people-has clearly emerged as a critical constraint on the effectiveness of investment in physical capital. For example, in many countries the ratio between capital and technical assistance is out of balance, and shortages of human skills and inadequacies in management and administration have restrained increased investment and growth. At times, more external financial flows may be available, but they cannot be utilized effectively.

In the history of development assistance, technical cooperation evolved more or less as an adjunct to capital assistance and investment programs. It provided advice on policy measures to facilitate capital formation, rendered direct services for pre-investment studies, and developed skills to manage and operate newly created enterprises and services. Needs in technical cooperation, however, are constantly changing and expanding. At present, an increasing number of countries are looking to structural changes in international trade and to the transfer of technology to provide the major impetus to their continued growth. Many countries have reached the point where existing levels of technical cooperation are no longer adequate; higher, more sophisticated levels of training and experience are in increasing demand.

The troubles afflicting development progress in the 1980s serve to bring this issue into sharp focus. The IDA in Retrospect, for example, evaluates a number of IDA-financed projects and sets forth reasons for their success, relative success or failure." A dozen or more projects which encountered difficulty are treated in some detail. Close examination of these difficulties shows that 3 out of 26 identified problems relate to such externally rooted difficulties as fluctuations in import or export prices, changes of government or climatic variations. Almost all the rest were attributable to inadequacies in human or institutional resources. Two projects exhibited overemphasis on capital-intensive inputs without adequate local support systems. Two overestimated the developing countries' technical or managerial capacity to absorbs inputs. Three foundered because of "mismanaged local support agencies." In three more, lack of skilled workers was a contributing factor.

Despite the evidence indicating the importance of technical cooperation in the development process, only about 22 per cent of all ODA funds are currently allocated to technical as opposed to other inputs, and this proportion represents a

decline from a few years ago. The statistics are all the more disconcerting when the divergence of needs of the developing world is taken into account, and since a large majority of developing countries are unable to achieve the growth rates to which they aspire. In this light, the question arises whether the current share of technical cooperation in ODA is sufficient. And then another issue arises: the advisability of a special target or ratio for technical cooperation within the global ODA target.

Doubling of Technical Cooperation Inputs

The purpose of these remarks is not to minimize the critical importance of capital investment in developing country progress, but to encourage the adjustment in ODA which the experience of capital investment itself indicates is required. Roughly over 10 per cent of World Bank/ IDA loan commitments currently go to technical assistance, though they are often directed toward immediate supervision, implementation and engineering services rather than to longer-term necessities. According to the OECD/ DAC report for 1982, total member country bilateral assistance (ODA) came to $18,283 million, of which $5,248 million or 28 per cent was consigned to technical cooperation activities. The UNDP record of development cooperation reports by country, compiled annually by UNDP field offices, shows a ratio somewhere between. On the one hand, for such countries as India and Malaysia with strong human and institutional resource structures, total external technical cooperation financing in

1981 (the latest year available) amounted to about 7 per cent (India) and less than 3 per cent (Malaysia). On the other hand, for certain least developed countries, the percentage going to technical cooperation was much higher, in some cases almost 50 per cent. At the same time, many major oil-exporting developing countries required little or no capital assistance, so that about 100 per cent of their external assistance took the form of technical cooperation.

Given the great differences among developing countries, no single ratio of capital/technical development assistance is appropriate for all. What is clear beyond doubt is that human and institutional resource factors continue to be neglected, even in least developed countries, in spite of the relatively higher ratio of technical to capital assistance that obtains in those countries. Similarly neglected are organizations which support the strengthening of such factors, particularly for the poorest countries. According to the distinguished economist and Nobel laureate, Simon Kuznets: Ninety per cent of development in the past in the industrialized countries was due not to additions to capital, but to improvements in man's capacities: skill, know-how, management, etc. Man's capacity, not capital, is the number one multiplying factor in the process of development. It is the main condition for a more efficient use of resources."

While Kuznets reached his conclusion on the basis of economic studies of industrialized countries, it may also be relevant to developing countries. As Theodore W. Schultz states: "Increasing numbers of economists have now come to realize that standard economic theory is as applicable to the scarcity problems that confront lowincome countries as to the corresponding problems of high-income countries."[10]

How, then, might the development process in general be restructured to meet the urgent needs of the 19805? A clue might wisely

'>simon Kuznets, Modern Economic Growth: Rate, Structure and Spread (New Haven: Yale Univ. Press, 1966). u Schultz, Investing in People, p. .

be taken from the developing countries themselves, which have borne the main brunt of the development effort for 30 years, It has been noted earlier that the investment of these countries in so-called social technologies-education, health, social welfare and services, etc.now equals nearly two-fifths of the resources they currently devote to capital formation. This is roughly twice the average 20 per cent of ODA traditionally devoted to technical cooperation as a whole, including highly technical and specific pre-investment, research and scientific requirements. In general, technical cooperation as a whole captures a far broader range of human and institutional resource development than basic social

technologies. What is suggested, based on the developing countries' own aggregate performance, is a rough doubling of technical cooperation inputs into the process, supported by ODA over a five-year period. The addition need not and should not be at the expense of capital assistance flows, but rather should be a solid, long-term supplement for their increased effectiveness. Establishment of Priorities for Development by Developing Countris UNDP was established on the eminently sensible premise that, because their needs and resources vary so greatly, developing countries are themselves the best judges of their own development priorities. Yet the drift of the development effort over the past decade has exposed a growing lack of faith in this premise and tendencies by some donor governments to target their assistance toward their perception of priority needs and by some recipient countries to accept this trend, This is extremely serious because it reveals the extent to which the international community has been retreating from sound and proven development principles. The decline in multilateralism in development assistance and the growth of tied aid and special purpose arrangements are all evidence of this trend.

Some basic truths of development are worth recalling in this respect, because they demonstrate the error of the current trend. A developing country is developing because it has scarce or untapped resources which the country does not have the institutional skills, structures and the capital to harness. If resources, both human and material, are scarce, it follows that their use must be planned as carefully as possible, so that maximum benefits accrue from their economic activation. These truths apply, of course, to all countries, developed and developing. For developing countries, the extent of skilled human and material scarcity is so great, or so uneven, and the needs to be met are so huge, that the most careful planning and the

Hardest choices are required in their activation. There is also much diversity in strengths and weaknesses among developing countries. Some are strong in human resources but weak in material resources, and the opposite prevails in others. It follows that there can be no set of priorities in aid that applies equally to every developing country. One of a developing country's first tasks is therefore to take stock of its internal resources, its strengths and weaknesses, so as to integrate external assistance effectively into its particular circumstances. A first task of the aid establishment, in turn, is not only to help ensure that this assessment is done correctly but also to help the country establish or strengthen the machinery required to make the assessment, so that the country can do the job for itself in the future and keep its assessment up to date. For external aid to make its maximum impact, the flow of assistance must augment the pattern of resource distribution in the country, going more to those areas where endowments are weak and proportionately less to those areas where strengths are greatest. In other words, the peaks and valleys of external assistance must mesh with the valleys and peaks in the planned resource distribution of the country itself. Finally, it follows that to achieve such a practical meshing requires a mechanism by which the total aid available is known, and that a cooperative arrangement exist among all donors, bilateral and multilateral, together with the understanding that, once the country has in good faith and with competent help prepared its program, external assistance be integrated and dedicated to the achievement of the program's objectives.

This is the true path of development. However, in practice, some donors tend to exercise greater control over the direction of aid flows, whether because of their own perceptions of priorities, or in order to encourage domestic support for their assistance efforts, or for whatever reason. Some developing countries tend to acquiesce in this evolving pattern of control, even to the extent of accepting aid when it appears the project may collapse once external assistance has been withdrawn. The discipline essential to any process applying scarce resources to long-term needs is thus eroded. And this is particularly problematic at a time when resources for the development effort are becoming more constrained.

The kind of technical assistance provided bilaterally today does not always match the true needs and priorities of the recipient
countries. As pointed out by John P. Lewis, Chairman of DAC in 1981, this type of assistance is mostly very fragmented, and the experts sent out reflect for the most part the development skills and program priorities of donor countriesJS Professor Lewis therefore suggests that the donor countries should make commitments of skills and financial support for skills on a country, subregional or regional basis, and that the recipient countries would play a leading role in the programming of such a pool, so that it would be most suited to their needs.

The foregoing analysis leads to the conclusion that comprehensive programming and coordination of external inputs is a task which can only be done by a developing country itself, with the support of impartial multilateral, multicultural organizations without biases favoring one sector over another or putting one need above the rest, but which respond to the objectives of development as determined by the developing country itself.

**Meeting Changing Needs**

Much was learned in the 1970s about the nature of the development process. Developing countries acquired valuable experience in planning and managing their own development programs based on local values and conditions. They placed increasing emphasis on self-reliance and on mutual cooperation among themselves, becoming aware of their common problems and interest in joint action. It has been realized that development can no longer be considered simply as a process of adopting industrialized countries' models in linear, mimetic fashion. Development is increasingly seen as an undertaking that should be geared to the human factor both as agent and as beneficiary; it should be endogenous, involving the definition by each society of its own values and goals; it should rely primarily on the strengths and resources of each country; it should encompass the transformation of obstructive structures, both national and international; and it should be in harmony with the social environment and respect ecological constraints.

Since the inception of multilateral technical cooperation, the prevailing concept has been the transfer of know-how to developing countries through technical advice and training facilities. However, it is now acknowledged that, while the important results obtained from
technical cooperation prove the concept to be a valid and useful one, the magnitude of the task has been vastly underestimated. The transfer of knowledge through individuals (experts and local counter parts) is only one link in the complex chain of development assistance, The problem of the transfer of know-how and technology is intimately connected with the absorptive capacity of a given country. This requires that much greater attention be given in technical cooperation activities to national institutions and human resource building and that the international system reinforce local initiatives in harmony with national aspirations.

In addition to a review of the very concept of technical cooperation, a review of the existing structures and procedures for multilateral technical cooperation has been suggested by same authorities. The present United Nations development system for such cooperation is the outcome of an amalgamation of different mechanisms established in a piecemeal and ad hoc manner, and not the result of a grand design. From its earliest days, the United Nations and its specialized agencies have rendered various forms of service to developing countries through different technical assistance programs created essentially in an empirical manner. In the case of the United Nations itself, the process started in 1946 with the creation of the Advisory Social Welfare Service, and continued with the establishment of the United Nations Regular Assistance and the Special Fund. With the establishment of UNDP, these activities acquired a more comprehensive, multicultural and multidisciplinary character.

The basic fields of assistance and types of projects undertaken by the United

Nations development system at present are mainly in socalled “soft-core” areas of development, such as health, education, agriculture, manpower, and public administration. The forms of assistance consist of: (a) services of experts and consultants; (b) equipment; (c) training programs; (d) fellowships; and (e) pilot and demonstration projects. Since the establishment of the criteria governing both the fields and forms of assistance provided by the system, however, far-reaching changes have taken place in respect to development and international cooperation. At the same time, the technical cooperation requirements of developing countries have been constantly changing, expanding, and becoming more complex and sophisticated. Although requirements for international technical cooperation in basic development sectors such as agriculture, education and health still maintain their importance, priority is increasingly being assigned to such areas as energy, trade, marketing, industrialization, financial management and monetary matters, informatics and computerization, and environment.

Under these circumstances, it is essential that the dynamism and relevance of the technical cooperation activities carried out by the United Nations development system be maintained and enhanced. It is essential that the system respond with innovative approaches to the ongoing, changing and new demands of the developing countries. For example, certain categories of developing countries, especially the middle-income and semi-industrialized ones, now require a different, more complex type of technology than the one which has been provided over the last three decades. Increasingly, these countries are demanding shorter-term; highly specialized expertise, undertaking well-defined tasks. In this respect, it may be argued that the expertise provided and projects implemented by the United Nations development system are often too basic in kind and/or content to meet the changing needs of these countries. Besides, in many developing countries, well-trained nationals are emerging as qualified experts capable of implementing projects designed by organizations of the system. In many cases, instead of full-time outside expertise for project management, the advice and support of short-term consultants may suffice for successful project implementation- Moreover, there is a growing recognition of the need for a multidisciplinary and integrated approach to development problems. Since the majority of projects undertaken by the system are of a sect oral nature, there may therefore be need to design more projects of a multidisciplinary character.

**More Fruitful Cooperation with the Private Sector**

Economic growth and equity in sharing its fruits should be considered as complementary rather than conflicting objectives. Common sense requires that the claims of growth and equity be balanced. Human resources have an undeniable, direct bearing on the pace and pattern of growth. Growth must not be measured solely in terms of an increase in wealth. Rather, the ultimate aim of economic growth should be to satisfy the fundamental needs of human beings, promote their skills and knowledge, and improve their standard of living. In many countries, the private sector plays a crucial part in promoting economic growth in partnership with the national government. The strength of the private sector in this partnership lies first in its ability to create new job opportunities and ensure higher income possibilities and second in its ability to help to ensure the transfer of technology, improve skills, increase productive capacities and deliver managerial know-how, including technical and scientific expertise.

What is required at present is a greater understanding of the fact that the immense task of redressing the gross imbalances of wealth and opportunity in the world cannot be settled at the governmental level alone. The contribution of the private sector to this process can be crucial. What is still lacking in both the business world and governmental circles is a real understanding of how important this contribution may be. The challenge of economic growth and the spreading of its benefits is addressed not just to governments, but to all sectors of society.

Similar changes are required at the intergovernmental level. The development dialogue to date has been primarily a dialogue between governments, based on the common belief that only they can best ensure the transfers of resources and of technical assistance necessary for economic development. There is little recognition in such dialogue of the role which the private sector can play. For example, with regard to the transfer of technology, so essential to the progress of developing countries, the simple fact that most of the required technology and know-how may be found only in the private sector is often overlooked.

Multilateral technical cooperation has traditionally been provided through governments to the public sector of developing countries. Only in rare cases has the private sector in these countries benefited from such assistance. Experience of the 1960s and 1970s shows that the private sector played a very important role in the buoyant development performance of some developing countries. A lesson to be learned from this is that consideration might be given to stimulating the private sector through multilateral technical cooperation in developing countries where such activities would be appropriate and fruitful.

In addition, the private sector in developed countries could be tapped to increase the flow of resources and expertise through multilateral cooperation. To date, this has happened rarely, perhaps because of apprehension on the part of developing countries and because of the lack of understanding of the complexities of the development process by the private sector in industrialized countries. Consideration could be given to the creation of new and appropriate multilateral means and mechanisms for channeling resources, expertise, know-how and equipment from the private sector of developed countries to developing countries for technical cooperation.

**Recommendations**

To sum up, the challenge of development for the 1980s lies in fostering better understanding of the essential role of technical cooperation and human resource development. The greatest needs in this respect are:

- Heightened recognition of the essential role technical cooperation plays in the development process, especially in relation to capital assistance.
- Closer linkage between technical cooperation and capital assistance, and a broader cooperation between multilateral agencies dealing with technical assistance and those providing capital assistance.
- Establishment of a more specific target ratio of technical cooperation allocations in GDA funds so as to meet more effectively the evolving needs of developing countries for human and institutional resources.
- A doubling of technical cooperation inputs over a five-year period to supplement growing capital assistance development funds.
- Full recognition of the need for developing countries to establish their own development priorities, so as to maximize the integration of the various sources of external aid into national development programs and-what is particularly important in times of scarce resources-to maximize the impact of such assistance.
- Greater attention in international technical cooperation activities to national institution building and human resource development, and to the reinforcement of local initiatives in harmony with national aspirations.

A review and reorientation of the existing domains of and procedures for multilateral technical cooperation, in order to



maintain its relevance to the expanding and increasingly complex needs of the developing countries.

- More sustained technical assistance to the private sector of developing countries, and creation of the multilateral mechanisms needed to channel the technical resources and expertise of the private sector of industrialized countries to the public and the private sectors of developing countries.

The time has surely come for a new understanding, based on the hard-won lessons

of experience and on the basic truths of the development process as we know them. A renewed sense of discipline and determination can move us in the right direction, for the benefi of all.

**CHAPTER 21**
## Building Human Resources in the Arab Gulf
**Nemir A, Kirdar**

The ultimate desire of any nation is to achieve a high standard of living for its citizens: to have a productive, healthy and educated populace which is motivated, prosperous and responsible. The achievement of such goals is subject to an infinite array of limiting factors which make the measurement of success very difficult. Each country attempts to utilize its internal resources, and all those that it might be able to obtain or borrow from abroad, to the greatest extent possible, in order to accomplish these objectives.

The six Arabian Gulf countries on which 1 will focus in this paper-Saudi Arabia, Kuwait, Bahrain, Qatar, UAE and Oman are no exception. Indeed, over the past decade, all of them have worked vigorously and admirably towards the above goals. But these six Gulf States are different from many other LDCs in several respects. The Gulf States are very much under populated. And although until some fifteen years ago they were severely under-developed-lacking basic infrastructure, education and healthcare facilities and surviving on extremely limited incomes-in 1973, huge sums of money became available to the region, and for the past ten years capital has not been a constraint.

The Gulf states moved with enormous energy and ambition to fill the gap which had been inherited over the centuries. They built nearly everything from a zero base and did so within a remarkably short span of time. This required more than just the availability of capital. This building process needed trained human resources, a resource which was not then available domestically. As a result, the Gulf states had to import millions of foreign laborers and skilled workers to carry out the various development programs. At the same time, however, these countries made tremendous progress in educating, training and developing their own people. Over the next few years, significant additional efforts will be concentrated on the development of productive young Gulf citizens. This paper focuses on the dynamics of such development, in retrospect on the past and with prospects for the future.

Although I shall focus on the Gulf States, it would be useful to look at the issues from a broader perspective and relate the conclusions to other LDCs which basically face similar challenges of working towards improved human resources. It is also important to consider the future interdependence with other countries, given that human and economic development in the Gulf region cannot be accomplished in isolation from the rest of the world, and given that interaction

with many other countries over the past ten years has been substantial.

In order to appreciate the circumstances of each of the six Gulf countries, let us take a look at the human resource development efforts of each one of them more closely.

Kuwait's first "school" in the modern sense was established in 1911, the earliest school of any Gulf country.' It was private and had forty students-all male. There was no public school in Kuwait until 1937. Saudi Arabia had no government-sponsored schools until 1939. In Abu Dhabi in 1960, there were three schools with an all male student population of 81. Oman had five schools in 1970 at the accession of Sultan Taboos: three all-male primary schools, a private mission school and a technical school operated by the oil company. Now the Gulf countries are rushing to close the education gap. Over 20 per cent of the population of the Gulf countries is currently attending school, either full-or part-time, except in Oman, where 12 per cent are in school. Every Gulf country has at least one university, technical schools and vocational schools, and is pouring money into building new schools, new libraries and other facilities. The number of universities in the Gulf totals seventeen, but academic standards varies.

Amid the drive for human development, however, a number of important issues have arisen which will determine whether the investment being made in human capital in the Gulf is likely to make a good return, or whether the investment should have been made in some other form. No one disputes that the native manpower problem in the Gulf must be dealt with, but there have been questions raised about a number of methods used to produce a well-trained citizenry.

The proportion of foreign labor in all of the Gulf countries is substantial, in all cases over one-third, and in the smaller states, usually over half. Each country, however, has its own variation on this theme. Saudi Arabia has a 43 per cent foreign labor force) Many of these are Arabs from the surrounding countries, especially Yemen, who generally perform unskilled Labor. Recently, increasing numbers of workers have come from Asia-Korea and Pakistan—as the construction effort demands ever more cheap labor. Bahrain, the most self-sufficient of the Gulf states, has a foreign labor component of only 37 per cent,4 due to its mature edpcational system and its well-trained and relatively numerous population. At the other extreme is Qatar, where natives make up a bare one-fifth of the total population and 17 per cent of the labor force.' Oman, the least oilrich Gulf state, has 35 per cent foreign labor, mostly from the Indian subcontinent. Ironically, this is not because Oman has insufficient native labor. The problem is that much of Oman's native labor force migrates, usually as unskilled workers, to the better-paying countries such as the United Arab Emirates and Saudi Arabia, leaving a gap to be filled by foreign workers More than in most developing nations, the task o£ stemming this rising tide of foreign workers in the Arab Gulf has fallen to the central governments of the countries concerned. This has come about regardless of the fact that each of these governments is, to a varying extent, committed to the encouragement of the free-enterprise system. In all of these countries, land tenure and the nature of the traditional political system, with the central authority acting as the caretaker of the national resources for the benefit of the people, have acted to concentrate oil revenues in the hands of the government. Especially since the 1970s, these governments have acted to distribute the benefits of this new wealth to its citizens, tq improve their economic well-being, and to establish a sound basis for continuing prosperity and stability. gainer Cordes and Fred Scholz, Bedouins, Wealth and Change (Tokyo: The U.N. University, 1980). p.54.

Most notable in this regard is Saudi Arabia, with its three Development Plans. The First Plan, for the years 1970-1975, budgeted 41.3 billion Saudi riyals, most of which was for infrastructural development. By the time of the Second Plan, in 1975-1980. SR 498 billion (or $149 billion) was budgeted from the newly-enriched treasury, 50 per cent of which was budgeted for infrastructure and 25 per cent

devoted to productive industry. In the Third Plan, 1980-1985, the percentage dedicated to productive industry is to rise to 37 per cent of the $235 billion budget .[7] Other Gulf countries have had mixed experience with large-scale government planning. Bahrain has a plan of four years, its first covering the period 1982-1985. Oman has undertaken five-year plans, on the Saudi model. Qatar has no short-range planning, but followed a development model based on a report prepared in 1973 by a British consulting firm in establishing its infrastructure and heavy industrial base. It is expected to develop light industry in line with recommendations now being prepared by a French firms In all the countries, with the emphasis upon planning and the predominance of the government sector, a great deal of thought has been expended on '~ various methods to achieve the goals of reduced dependence on foreign labor and increased local skills.

During its development experience Saudi Arabia has become more and more acutely aware of the need to train local manpower. In fact, during the Third Development Plan, Saudi planners hope finally to turn the past influx of foreign workers around and to put Saudis in many staff and technical positions as well as most senior management positions, in private industry and contracting as well as in government. In this task, the government has come face-to-face with the most daunting aspect of this problem-the trade-off between physical capital and human capital development. That is, in order to consolidate local control over the economy, the headlong growth of the past decade must slow.

This is precisely what Saudi planners foresee. Whereas growth in gross domestic product (GDP) was over 15.1 per cent per year from 1975 to 1980, during the Third Plan it is slated to rise at only 6.2 per cent yearly. Growth in the labor supply, 7.19 per cent per year during the Second Plan, falls to 1.16 per cent per year in the Third? it is important to note that Saudi labor is to grow 1.9 per cent per year, but foreign labor is to grow only 0.2 per cent annually. With such a small growth of labor, even the low figure of GDP increase cited will be difficult to attain. Much of the rise, clearly, must come from a rise in productivity, a calculated risk on the part of the government.

The classical view of developing countries is that the labor force needed to sustain an industrialization drive should come from the agricultural sector, which releases surplus labor as mechanized methods of agriculture are applied. This actually happened in Saudi Arabia, where an agricultural labor force of 40 per cent of the population in the past was reduced to only 24 per cent by 1980.[10] This transfer from agriculture to unskilled labor, mostly in construction, is essentially over now. For further increases in GDP, this labor force must be made more efficient, i.e., it must be trained.

In Saudi Arabia in 1971, 85 to 90 per cent of the population was illiterate. I Of course, since that time enormous investments have been made in schools and education. But one should realize that a country which was 90 per cent illiterate twelve years ago will not be running its own petrochemical plants tomorrow. Such things take time. However, enormous progress has been made.

In the first two Development Plans, Saudi Arabia concentrated on building infrastructures for human resource development—building schools, technical institutions, colleges. By the time of the Third Plan, however, it was clear that the simple building of schools, hiring of teachers (usually Egyptian) and the filling of classrooms with students would not necessarily lead to a well-trained labor force. For one thing, the curriculum was not adapted to the purposes of Saudi Arabia. As in all the Gulf countries, the education system used had been adapted by Egyptian teachers from the old French system, from the time when education was only for the wealthy or those who were interested in government service. Education was highly disciplined but theoretical, teaching language, history, arithmetic and religion. Students emerged from the system having academic information at best, but few immediately usable skills. For this reason, the Third Plan established an Educational Development Center in the Ministry of Education, which would emphasize the development of new curricula based on identified needs." Also to

be established are Regional Institutes of Education, which may oversee educational planning according to the needs of each region of the country.

The most important body overseeing manpower training in Saudi Arabia during the Third Plan is to be the (nterministeria( Committee on Manpower, which wilt coordinate and oversee manpower development programs in both the public and private sectors)" It will oversee planning in higher education to ensure that sufficient training in needed skills is provided. Also, a polytechnic institute is to be established, and on-the-job training will be expanded to upgrade the efficiency of those already working by ensuring that they are fully conversant with all the skills necessary to fulfill their duties. According to Crown Prince Abdullah in a recent interview, the decline in oil production and prices will have no major effect on allocations for the Five Year Plan, although some projects may be rescheduled.[1]d

Turning to Kuwait, we see a more mature economy suffering from some of the problems Saudi Arabia is trying to avoid. That is, with a better educated work force and a history of social welfare. Kuwait has a long-standing policy of reserving a place in the government for its citizens, which has resulted in a top-heavy bureaucracy. Some 73.9 per cent of Kuwaiti native labor is in the service sector, predominantly the government. In this case, what might in one way be considered a blessing-the notarization of government service—is in other ways a disadvantage. Some 59.3 per cent of the Kuwaiti national labor force is either illiterate or has less than a primary education." That is to say, there are large numbers of illiterates in the lower levels of government. Competent administrators often waste considerable time managing and correcting the mistakes of their fellow employees.

Kuwait has compulsory education from ages six to fourteen, but only 58 per cent of children actually attend school. Kuwait's school system, like Saudi Arabia's, primarily trains future bureaucrats. If students are successful in school and wish to enter senior government positions, they go to university, either Kuwait University or abroad. Until 1976, Kuwait University offered only humanities courses, though it now offers scientific training as well. Those who train abroad usually go to Egyptian or American colleges. In 1978, of 2,925 Kuwaiti students abroad, 1,083 were in Egyptian institutions and 1,367 in American institutions)°

Of those who fail in college or cannot gain entry, many take the government subsidy for technical students, while continuing to seek employment in the government. A 1974 study revealed that 49.2 per cent of vocational school graduates neither accepted nor preferred manual work, despite the fact that this was what they had been trained for. Moreover, of those technical school graduates who worked in their field, 8.6 per cent required retraining.[17]

These points out a problem endemic to the Gulf, indeed to the Arab world: there is a strong cultural disdain for manual labor and for those who perform it. Moreover, such workers are not paid as well as "white collar" workers of the same educational level. For example, the Industrial College was established in Kuwait in the early 1950s. In 1956-1957, it had 98 students out of a capacity of 600. In 1974 it had 164 students.'s although a Central Vocational Training Directorate was established in 1972 to improve, coordinate and evaluate various training programs, there is still a serious problem and further improvements are necessary.

From the formation of the United Arab Emirates in 1971 until 1978, education was the highest item of expenditure in the national budget after defense.[1]B Most of this expenditure again was on construction of school buildings. Still in 1980, 22 per cent of the education budget went to construction while the rest went to the Education Ministry's current expenses.[3°] Interestingly, the current expenses of most UAE schools (except in Abu Dhabi) are paid for by Kuwait, in a long-standing aid program it has adopted in other Gulf states as well.

As for higher education, the University at Al-Amn emphasizes training for UAE citizens in all aspects of the oil industry, although it is open to any national of a Gulf state and to expatriate Arabs. In regard to technical training, despite

financial incentives, few students attend vocational centers. There were 258 students in technical schools in 1972, and only 70 in 1978; there were 40 students in agricultural training in 1972, and 8 in 1977.'[1]

In Qatar, the strict control exercised over the budget by the Ruler and his ministers, which has saved the country from economic instability, is "one of the main problems facing education in the coming two decades.'nr The necessity to obtain the Finance Minister's signature for every major expense inhibits the Education Ministry's independence.

Qatar has a university which just opened in 1982 in the new West Bay development area near Doha. It has schools of science, engineering, humanities, education and Shari (law). There are three specialized secondary schools: Doha Technical School, the Commercial School and the Institute of Religious Studies. In 1970 a Management Institute was established to give a two-year course in various management-related fields-accounting, statistics, public finance-for in-service training of government workers. Also, a Regional Center for Vocational Training was set up in 1971 to establish national policies, to provide training for instructors and on-the-job training, and to organize apprentice training programs.

Qatar has instituted a unique program to gain access to foreign labor under reasonably stable conditions. It has made arrangements with Egypt, Tunisia, Morocco and the Sudan to admit workers from these countries without a visa, in order to alleviate its desperate labor shortage.

Bahrain's position with regard to human resource development has been greatly enhanced by a number of historical and geographical factors. First, the historic "Red Line" agreement, intended to monopolize Arabian oil for the old Anglo-Persian Oil Company in the early part of this century, ironically led to the discovery of oil in Bahrain in 1934, outside the agreement's enclosure. A tradition of trading on the strategically placed island meant that the island's people were open to outside influence, especially if they scented profit. The result has been a liberal atmosphere and a well-educated native population, since thee island has taken advantage of its oil revenues to train its populace.

Oil revenues, never great, have declined in Bahrain, but it has used its central position and trading history to establish itself as banking and manufacturing center for the entire region.!This position, founded on the basis of liberalized banking regulations, has by now become well-established and has acquired for Bahrain a well developed labor force. In the manufacturing sector, the establishment of Aluminum Bahrain's (Albs) rolling mill eleven years ago as the first Arab Gulf regional heavy industry has led to the recent award of several heavy industrial manufacturing projects by cooperating Gulf countries. These awards resulted directly from the Bahraini nationals' experience and expertise in heavy industrial manufacturing.r[3]

Also in regard to formal education, Bahrain's regional position has enhanced its achievement. Today there are fresh plans for reorienting Bahrain's educational system, starting at the primary school level. Education in the past emphasized learning by rote. The text books were narrow, and there was little variety or choice either for the student or the teacher. The current planned improvements aim to inject stimulus into learning The primary school system has been suffering a drop-out rate of 18 to 20 per cent yearly, and failures have been left by the wayside instead of being assisted. The goal now is to get the drop-out rate down to 1 or 2 per cent a year, but in case results are not quick, legislation is under way to introduce compulsory education for all children between the ages of six and sixteen.

The new-style teaching methods will be introduced by Bahraini teachers instead of Egyptians. The institutes of higher education are now producing around 200 teachers a year, so that the number of foreign teachers can be reduced. In order to recreate prestige in the teaching profession, the Education Ministry is hoping to make the career financially attractive and intellectually stimulating. The Ministry is therefore moving to decentralize decision-making, to involve the

teaching staff more in deciding the curricula, and to provide periodic refresher courses so that a teacher's education does not come to an end with graduation.

A good educational structure is vital to Bahrain, for without a skilled labor force, the island cannot function as a service and industrial center. "We only have human beings in Bahrain. We don't have much oil or much cash, so if we don't build our human structure, we have nothing." In recognition of this paucity of financial assets, the six Gulf Cooperation Council states and Iraq have decided to Locate the Gulf University on the island. The Arabian Gulf University will be designed as a postgraduate university specializing in the sciences, offering research facilities and promoting a standard of excellence not yet seen in the area. The Bahrain institution will attempt to operate a kind of think-tank on the region's problems and needed technology.

Natural population growth and the predominance of young people in the population will fill a minimum of 4,000 new jobs a year. Bahraini male employment is expected to rise from 49,300 in 1981 to about 19,000 in 1991. Predicting the future employment of Bahraini women is more difficult. In 1971 over 4 per cent of all women were in the labor force, but ten years later this figure had more than tripled. In the age range of 20 to 24, over 29 per cent of Bahraini women are already working.

At the moment, the shortage of skilled manpower has placed a premium on Bahraini employees, and most private sector firms spend a lot of time pursuing suitable candidates. Meanwhile, the influx of foreign workers continues. Last year Bahrain imported over 33,000 foreign laborers, marginally above the 1981 figure and far more than the 18,665 brought in in 1979. Of the workers imported last year, over 20,000 were Indians, followed by other Asians, especially Thais and Koreans.[2o]

Oman's labor problems differ from those of other Gulf States, as its economy differs from those countries'. Oman's oil revenue is less than that of any other of these states except Bahrain; its population is Larger than any except Saudi Arabia's. This has meant that development has proceeded less rapidly and less completely. School building has not proceeded as quickly, and fewer citizens have access to education, as has been noted.

Agriculture in Oman is much more important than in other Gulf countries, employing 70 per cent of the labor force although it accounts for only 2.8 per cent of GDP, and attracting far more attention in the development of both physical and human capital. The principal target of the Second Five-Year Plan (1980-1985) is to assist farmers and fishermen by teaching them better production methods as well as by improving the marketing of products. Research centers are to be established for soil studies and improved wheat yields. Animal husbandry research stations are to be established at Rumais, Rustaq and Salalah.zs A major problem with such research stations is that there has not been enough formal training for farmers, and so new techniques are not spreading quickly. However, some facilities-for example, factories built at Nizwa and at Rustaq to improve preparation and production of dates for export-have made progress in training farmers.[20]

Of four USAID-sponsored projects now being initiated in Oman, three involve the education of Omanis.2[7] the largest is a $31 million. scholarship program to train Omani in the U.S. or in Third world countries in development-related areas, such as business, economics and agriculture. The project includes assistance to the Omani Ministry of Education to plan training programs. Another project provides $25 million for the construction of twenty-three schools by Omani firms. A third establishes an advisory and training program for fisheries.

This June, Oman began exporting finished copper from three mines in Sonar. This mining/refining venture, carried out by the Oman Mining Company, a state-owned company, entails the first export of a non-hydrocarbon natural resource from the Arabian Peninsula.[28] Regardless of the short-term potential for copper export, the company hopes that this can develop as the basis of a large

Gulf mining center by establishing local expertise, much as Bahrain has done in manufacturing. The company is training workers in heavy-duty equipment operation and other tasks.

From these quick glances at the Gulf countries, one may gain some insight into several aspects of human resource development in the area. Certain characteristics, such as government domination of the development process, the need to increase local skills especially in technical areas, and the need to diversify expertise from the oil and service sectors to other productive enterprises, are common to all these countries. But variations are also apparent, with signs of movement toward specialization in certain fields becoming manifest in some countries. Regional aid and cooperation are hopeful signposts toward future coordination of regional economic policies.

A general problem throughout the area lies in the small segment of the native population actually in the work force, which leads to a large percentage of the people living off the productivity of relatively few workers. This is especially a constraint in the labor-scarce economies of the Gulf. Of primary concern is the youth of Gulf citizens: 40 to 50 per cent of the population of each country is under 15 years old. This is due to high birth rates and improving health. Auguring well for the long-term prospects for increasing local labor supplies, in the short run the situation creates a net burden on the system.

Another problem is that, of those of working age, fewer are working than in the past. Especially from ages 15 to 19, however, this simply reflects increased educational opportunities. Again, long-term benefits, but short-term burdens. And also fewer older members of the potential labor force are working. This problem is due to the "safety net" created by extensive social welfare programs, especially in the wealthier oil principalities, inevitably, some who in former times would have worked are now able to take advantage of these benefits, whether out of necessity or out of laziness. Also, decreased employment among older citizens reflects the initiation of social security systems, so that many who have worked their whole lives may spend their declining years free from economic insecurity-and free from productive employment.

Among the factors determining the small relative size of the labor force, the most important is the underemployment of women. This problem is pernicious economically regardless of the social issues involved. That is to say, while it is true that this issue involves conflict between two cultural perceptions-that which would "free" women of their socially distinct role and that which would maintain it-there is no question that to prevent half of the potential labor force of a labor-scarce economy from working retards economic development. In Saudi Arabia, 6 per cent of the labor force, including expatriates, is female.[19] In Kuwait, there is a relatively large female labor force, about 10 per cent. Yet over half of the students at Kuwait University are female.3° The very prosperity of these countries perpetuates female underemployment, as men who earn enough to support their families may keep their wives at home.

Another aspect of this problem is that women who do work are overwhelmingly concentrated in the education, health and social service sectors. While it is true that these sectors are vital to the development effort, simple economics dictates that to place a factor of production most well-adapted for one task (for example, chemistry) into another task (perhaps primary school teaching) is a misallocation of resources. From this point of view, while there is much hope in statistics showing that all these countries have integrated women into public schools and universities on a large scale, this caveat must be mentioned: at the same time, equal effort must be expended in making all areas of endeavor open to women, on a basis of equal access. This goal, difficult in the short run, must govern long-term planning as a measure calculated to double available human resources at a stroke.

Qualified teachers are in seriously short supply in the Gulf. Advances in quantity have been at the cost of quality. In Kuwait, for example, until 1972, primary school teachers were taught by graduates of secondary schools?' Since 1970, Oman has

increased its teacher needs from about 100 to 6,000 at present, and will need 3,000 more by 1986.32 Teachers are largely young, under qualified, inexperienced and foreign. The quality of education they can impart will be severely limited for years to come. While great efforts are being expended by these countries to improve education, it must be realized that the first few classes, at least, will be of questionable quality until experience, allowances for local conditions and other factors can be adjusted.

An important goal of modernization in the Gulf is the development of entrepreneurial skills. By this is meant the expertise in product development, manufacturing and marketing necessary for expansion of the private sector. While it is possible to gain a theoretical knowledge of these areas, especially in business school, ultimately such skills can only be obtained through participation in the particular market for the product or service that one's firm sells. Governments in the region promote such training for local entrepreneurial talent by promoting joint ventures. In Saudi Arabia, as in most Gulf countries, foreign investors may not own a controlling share in any venture they may wish to launch; they must have a local partner who owns the controlling share. In this way the government encourages an outlet for local capital in productive industry, while encouraging foreign contribution of skilled staff, as a means of training local investors in entrepreneurial skills. Foreign investment in development projects is further encouraged by means of tax credits, land purchase and capital-import subsidies, etc." Similarly. Bahrain's liberal banking laws have been the means to attract foreign banks to invest locally, and in the process to train nationals in the field. Industrial estates throughout the Gulf attract foreign expertise in the hope of founding a native industry on that basis.

The private sector has also proven important in the field of education, training local people for their work. This is often a way in which a foreign company gradually replaces its own management team with native talent, effectively limiting themselves to equity participation.

On the other side of the issue of local participation lies the issue of how much to restrict foreign labor. Obviously, the marketplace does not distinguish nationalities; it rewards efficiency. Any restriction of the international movement of factors of production (i.e. labor) retards efficiency. National governments may put their nationalism ahead of national welfare by reducing labor input from abroad so severely as to cripple the local economy by inducing a scarcity of skilled workers. While there is some rationale behind a policy of increasing national capital at the expense of some short-term economic efficiency for the sake of long-term benefits in terms of increased productivity and labor stability, such a course can be overzealously pursued. Planners must keep these considerations in mind each time any specific antiforeigner measure is introduced, to guard against pernicious xenophobia.

Before planning for human resources may begin, it is necessary to have a complete description of their physical dimensions-population, labor force statistics, etc.- without which any such effort must be problematic. Already some progress in the statistical capability of the Arab Gulf governments has been achieved. The next step would be to consolidate these figures to form a consistent picture of the present inputs of labor and its recent movements. Only then can policy-makers consider solid economic data, evaluate it in the light . of perceived political realities, and make some determination about how to allocate movies. In recent years, the Gulf states have come to realize the importance of educating their people to maintain the new nations they are building. They will have to increase their sophistication to avoid the pitfalls inherent in such rapid development.

**CONCLUSIONS**

I. The Gulf experience to date clearly confirms that, although capital is essential, it

is certainly not the only critical factor needed to transform a society into a productive and advanced state. Effective plans of action ensuring the multidimensional development of human resources are vital.

2. Current restraints on growth in the Gulf and the changing economic environment, brought about by the reduced level of oil revenues, are dictating reevaluation of priorities and better management of existing resources. The attitude of "abundant capital" which has been so prevalent in the last ten years, is drastically changing to attitudes of realism, sobriety, prudence and thoughtful evaluation. The need for greater efficiency and more effective assessment of priorities is clearly pronounced throughout the Gulf region. "Trimming the fat," both in government and in the private sector, should produce a much healthier economic body.

3. There is a noticeable awareness in the Gulf States that productive human resources cannot be developed simply by providing academic or theoretical schooling. Special training centers, technical education and vocational development programs are now being developed throughout the six Gulf countries in order to provide their citizenry with practical and productive education and skills.

4. The quality, style and approach of primary school education is extremely important in the development of the productive Gulf citizens of the future. Children should be motivated to develop their own capabilities. They should learn to desire to learn. Major revisions in the existing curricula are being implemented throughout the Gulf, particularly in Bahrain.

5. The underemployment of women creates a major constraint. To prevent half the potential labor force in a labor-scarce economy from working retards effective economic development. Bahrain has made major improvements in this area.

6. A problem endemic to the region is the cultural disdain for manual labor and for those who perform it. A concerted effort through effective education processes is vital if these attitudes are to change.

7. There has been a tendency to permit the development of top-heavy government bureaucracy, as exemplified by guaranteed civil service employment of young college graduates. In my opinion, greater effort should be made to create interest in private sector business and in free enterprise. Individual innovation, contribution, initiative and "value added" are the necessary pillars for national progress.

8. Governments in the Gulf have been, I think, too generous in their welfare programs. This can be somewhat counterproductive as such well-intentioned benevolence might create disincentives to hard work. Societies can only be productive if the majority of their individuals assume concomitant responsibility. A consumer society which gets used to receiving unearned benefits cannot easily assume full responsibility.

Let us remember the outlook of the nineteenth-century British philosopher, Herbert Spencer, who took it as axiomatic that the continued expansion of the role of government reduces the field of individual initiative, prevents development of self-reliant, thoughtful and altruistic people, and eventually produces infantile adults, complete with "bib and pap spoon," who expect the state to feed and care for them.

# PART VI
# SEARCH FOR INSTITUTIONAL SOLUTIONS

"In all these areas-finance, money and trade-the absence of full-fledged reforms will not prevent change in the international system, but will only mean that such changes will occur outside of any consistent framework and without planning and cooperation." Michael Sakbani

# CHAPTER 22
## An Overview*
Khadija Haq

## THE NEED FOR INSTITUTIONAL REFORM

There is at present a great deal of debate going on about the need for reform of the international financial institutions as one of the answers to current and persistent problems in the world financial and monetary system. Some observers hold that the institutions established at the time of Breton Woods are proving themselves inadequate to the demands of the current situation and therefore need substantial reform or even replacement. Others claim that the institutions themselves are for the most part adequate to the job that their charters provide for the types of functions that need to be performed-but that it is the current interpretation and implementation of the charters which prevent the institutions from playing their full role in the resolution of the financial crisis. According to this view, it is political will, not institutional constraints, which stands in the way, and the argument for new institutional arrangements merely assumes the political barriers away. Nonetheless, it must be acknowledged that the international institutions, although subject to the will of the major governments, also exert some influence on governments-providing a code or a threshold of acceptable international behavior-and those institutional changes should therefore not be discounted as secondary concerns.
It is generally agreed that there are a number of flaws or gaps in the present functioning of the international financial and monetary system. Some necessary functions are being performed either inadequately or not at all. And a wide range of possible changes some of them broad institutional changes, some internal reforms, and some simply policy changes-have been suggested for filling the gaps and strengthening the international financial, monetary and human resource development mechanisms in order to perform their functions well.

## GAPS IN THE INTERNATIONAL SYSTEM

The following functions are some of those that are not adequately performed by the international system at present:
• Consultation and coordination of mineral policies among the mg/or developed countries: In order to reduce the unilateralism and arbitrariness of countries' monetary policies, which may have cumulative adverse impacts on the world economy, a greater coordination of these policies is called for. Individual countries' measures affecting their trade deficits, interest and exchange rates often have repercussions in the international system. Coordination is needed especially to dampen the wide fluctuations of interest and exchange rates experienced recently. At present, there is no effective forum for evaluation, discussion, and coordination of policies to ensure their consistency and aggregate effectiveness. Such a forum might include a small number of the major currency countries. One function now lacking at the international level, which such a

consultative group might perform, is the monitoring of the growth of world monetary aggregates, since the monetary base of the major countries is an essential determinant of inflationary or deflationary developments on the world scale.

• Joint consideration of the issues of money, finance, and trade. The critical condition of world finance at present has vividly revealed the close links between matters of money, finance and trade. The financial conditions in debtor countries cannot be resolved without improvements in their terms of trade. At the same time, recession in the industrialized countries brings a rising tide of trade protectionism. Yet there is no formal arena or mechanism for joint consultation and decision-making on these interconnected issues. An improved policy dialogue should be initiated among the actors in these arenas, particularly among the IMF, the World Bank, GATT and UNCTAD, perhaps leading to the establishment of permanent machinery for coordination of international policies on money, finance, and trade.

Creation and distribution of world liquidity: At present, the creation and distribution of liquidity on the world scale are related to decisions of a national government, i.e., the U.S., to movements of the U.S. dollar and to the ad hoc and uncertain actions of the private market. Recent changes in these factors have brought about the extreme volatility of global liquidity which now threatens the whole international financial structure. A more stable mechanism for liquidity provision is needed. Perhaps the IMP can play a more active role in this respect. The SDR was designed as an instrument for liquidity creation, but it has only been used in very limited amounts. There is a particular need for a new SDR allocation at this time, and the way should be cleared for SDRs to become a more broadly used international asset in the future.

• Lender of last resort: The present debt predicament has evoked a call from many quarters for the creation of a lender of last resort, or of some mechanism to fulfill this function. A lender of last resort is needed to provide support for those in difficulty, yet without encouraging imprudent borrowing and lending, in order to restore confidence in the international banking system. This is a particularly difficult and controversial issue, firstly because the “moral hazard” problems are hard to avoid, and secondly because the function of lender of last resort is commonly associated with the idea of a world central bank. The idea of a world central bank to perform this and other functions in the international financial arena has been a subject of debate since the time of Keynes. Proponents hold that some such institution, even with a very limited role, would enhance the stability. certainty, and equity of the international financial and monetary system, while opponents contend that such an institution is not feasible without a world central authority-a world government, in effect.

. Reorganization of the external debt of developing countries: At present, developing countries that find themselves in debt difficulties undergo reorganization of their debt in an ad hoc process with creditors and with the IMP acting as a mediator. This informal, hitter-miss approach has the advantage of flexibility. However, the rescheduling negotiated thus far have put heavy burdens of adjustment and large penalties on the debtors, while creditors have reaped the benefits of the process. The costs, in political, social and human terms, have been devastating for the developing countries. Most observers agree that minimum standards or broad guidelines are needed as a framework within which the negotiations can proceed, to lend more certainty and equity to the debt reorganization process. The answer may be the establishment of a new institution for this purpose, or merely a set of internationally accepted procedures.

• Risk management for new international lending.. In order to raise the confidence of potential new lenders to developing countries-for instance, pension funds and insurance companies of the developed countries-mechanisms for insuring investments and managing risks should be instituted. One proposal is the creation of a secondary market for bank credits. Another idea is to have institutional arrangements for the monitoring of country risks-a kind of country credit-rating

system. Yet another possibility is cofinancing between government or multilateral institutions and private financiers.

• Protection of the poorer countries within the international financial system: The world's poor countries are especially vulnerable to external changes in the world economy, such as commodity price and import price changes. Institutional mechanisms should be designed to protect them from shocks and to provide them with compensation. Some measures for this purpose could be taken within existing institutions: e.g., by expanding the IMF Compensatory Finance Facility and reviving the Extended Fund Facility or by a revision of conditionality for the poor countries. In addition, the possibility of institutions established by the developing countries themselves, for cooperation and protection of mutual interests, should be considered.

• Development of human resources: In the present crisis of money and finance, the element of human resource development tends to be overlooked. Yet the problem of inadequate human resources is fundamentally related to the current crisis, and if this inadequacy is once again not attended to, any solution of the crisis will be only a temporary one. The development of human resources means the development of management capabilities-not only high-level government management, but management of people, resources, and institutions at every level. Only with the growth of this factor can developing countries come into self-sustaining, stable economic development. More funding and support for human resource development should be institutionalized.

## PROPOSALS FOR REFORM OF EXISTING INSTITUTIONS

Some possible changes within existing institutions have been touched on in the foregoing discussion of institutional gaps. Still other reforms and policy changes might serve to strengthen these institutions for the present challenges of international finance.

Briefly, for the /MF, in addition to the need for a new allocation of SDRs to increase world liquidity, suggestions have been made to

Enhance the IMF's role generally in the flow of resources to developing countries. One suggestion is to raise the resources of the IMF by enabling it to borrow in the private market. In regard to its role in assisting and protecting the poorer countries, a review of conditionality standards and the creation of an array of resources, from high conditional to low-conditional, should be considered. Other proposals to this end are to liberalize the Compensatory Finance Facility and to revive the Extended Fund Facility.

For the World Bank and the regional development banks, a rededication to their true purposes is called for. The resources of these institutions should be strengthened so that they can play a larger role in international finance. Especially, the World Bank should be enabled to lend more for structural adjustment purposes. Another suggestion is that the World Bank might serve as a focus for new multilateral insurance arrangements, helping to provide a safety net for the international lending system. And finally, a reform whose time has long since come is the strengthening of developing-country influence in the World Bank management, both through increased voting power and through greater representation in senior policymaking positions.

For the United Nations Development Programmed, which provides a significant portion of the international funding for human resource development and technical cooperation, suggestions have been made to ensure adequate resources for the Programmed on a more predictable, continuous and assured basis while maintaining the universal character of the Programmed. To this end, it was proposed that different financial terms should be used to provide UNDP services to developing countries based on the level of their development: low-income countries would qualify for technical assistance on a grant basis; and middle-income and newly

industrializing countries would receive such assistance on a reimbursable basis, instead of being graduated out of the Programmer's support. It was also proposed that the UNDP should be enabled to increase its resources by cooperating with private foundations and multinational corporations, especially by making the technical resources of these organizations available to the private sector in developing countries. In this way, the UNDP could act as a catalyst to bring non-governmental actors into the development process.

In sum, the present failings of the international financial system make reform an urgent necessity. However, while certain gaps may

Require entirely new institutional arrangements, others may be bridged within the current institutional structures, through internal reforms and policy changes. In some areas, the world realities have outgrown the existing framework for international dealings; in other areas, the institutions have strayed too far from their original charters. These problems and their possible solutions should be pursued further in all interested forums, in preparation for a comprehensive conference on these matters in the not-distant future.

# CHAPTER 23
# The International Monetary System: Some Reflections on Institutional Reform*

**Sidney Dell**

## INTRODUCTION

Although the international institutions, as well as the "system" itself, are far from perfect, they are not the main source of current world financial problems. It is important to distinguish problems that are due to deficiencies in the institutions and system from problems that result from the macro-policies pursued. The macro policies of the past ten years would have caused strains in any system. The main cause of present difficulties in the Third World (including the debt problem) as well as in the OECD countries is the world recession. It could be said of the institutions that they provided little if any cushion against the world recession, and that the policies they advocated were the self-same macro-policies that created the difficulties. But this is only another way of saying that the national decision-makers who determine the course of the world economy also have a large weight in the institutions. The institutions could have offered much more resistance to the world recession than they did, even without any modification in present charters and rules, had they been allowed by their governing bodies to do so. The corollary of the above, of course, is that while useful changes could undoubtedly be made-and need to be made-in the system, such changes would be ineffectual if not accompanied by changes in the macro-policies.

This is not the place to spell out the nature of the macro-policies that are at fault. A brief indication of what is intended may, however, be useful. Neither at the national nor at the international level has a way yet been found of solving problems of income distribution. Since in most countries no effort is made to regulate income distribution on a rational basis, each social group and each country, insofar as it has the market power to do so, sets the price of ;• *its output at the level that will, it believes, maximize its income and share of income. If the struggle for income shares becomes over. Heated—often under the influence of a sharp fall in the real income of some social group or country, or of a major change in demand,' supply conditions-inflation is accelerated. The only method currently employed for dealing with such a situation is to treat it as a case of excessive aggregate demand—even if there is already substantial unemployment and excess

capacity. The remedy is to create sufficient additional unemployment and slack in the economy to make administered pricing more and more difficult. The remedy is at least as bad as the disease because it operates in such a way as to inflict the largest losses on those social groups and countries least able to bear them-and often least responsible for the origins of the problems. Unless a better way can be found of solving problems of national and international income distribution, and unless attention can be diverted from the problem of how to divide the cake, toward the more important problem of how to increase the size of the cake (which, as it happens, also helps in regulating the shares), changes in the system and in the institutions will be difficult to attain and not very effective in securing the desired results.

Two other introductory points seem worth making. The case for reform is fairly obvious. However, the prospects for reform are slim at present because of a lack of international convergence of views and policies. In fact the current symptoms of recovery may prompt some countries to conclude that the medicine used was responsible for the recovery, and that there is nothing wrong either with the system or with the institutions. (In reality the recovery is due more to discarding the medicine than to using it.) Complete identity of views and interests is not necessary for reform-a good system will tolerate diversity. But a minimum base of common assumptions is required, and so far this is lacking.

Finally, reform means institutional change (or at least change in the way institutions operate), but it does not necessarily require the creation of new institutions. We sometimes tend to assume that if an existing institution handles a certain problem in the wrong way, the remedy is to create a new institution. For example, the first Brands Commission Report said that since the World Bank does not do enough program lending, a new lending institution should be established to do so. But the case for such a new lending institution depends on a convincing demonstration that member governments that place tight limits on program lending in the World Bank would promote expansion of such lending in a new institution. Many of the proposals for new institutions take the easy course of assuming the underlying problem away. It is the oldest of devices, especially in the international field, to confuse the solving of problems with the creation of new institutions. Sometimes the institution-builders get their way, only to find that the new institution is powerless to carry out the wishes of its founders. This certainly does not mean that new institutions should be ruled out, but there is an onus of proof on the proposer that is not always fully assumed. A case is stated below for new institutional arrangements for dealing with the areas of inter-relationship among problems that are institutionally segregated at present. The need for such arrangements is compelling, but it must be admitted that the prospects for agreement along these lines are presently remote.

**MONEY, FINANCE AND TRADE**

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The most important single obstacle to the initiation of Global Negotiations has been the clash over interdependence of issues. The Third World has argued that problems of money, finance and trade cannot be dealt with satisfactorily in their present watertight compartments. The OECD countries have countered by pointing to the need to safeguard the autonomy of the specialized institutions dealing with these three areas. An important underlying consideration which influences this difference of opinion is the fact that the Breton Woods institutions operate under systems of weighted voting, while the United Nations, which seeks to conduct the Global Negotiations, has the system of one nation-one vote.

There are therefore two separate, though closely related issues: whether or not machinery is needed for bringing together problems of money, finance and trade for interrelated discussion; and whether decision-making at this global level should be by weighted or neighed voting. The fact that the second of these

issues is often uppermost in people's minds has tended to prevent adequate consideration of the first issue.

It can scarcely be doubted that there are serious shortcomings in a system that separates decisions on money, trade and fiancé as though they were unrelated matters. This is by no means an academic issue.

,When then President Nixon severed the dollar link to gold in August

,When he did so mainly because the existing international monetary "'rystem had resulted in international trade relationships that were

Unsatisfactory to the United States. Or, again, successive managing directors of the IMF have pointed out that substantial flows of tong term capital, coneessional and nonconcessional- are essential not merely for development purposes but also for supporting a properly functioning international monetary system.

At the national level, governments have the power to take a consistent view of money, trade and financial issues because the ministers responsible in these three areas sit in a cabinet presided over hay a single chief executive. At the international level, however, while there is provision for consultations between the specialized institutions concerned, there is no intergovernmental body empowered to confront the issues arising in all three areas simultaneously. The result is that, although each agency may at times take positions on matters outside the scope of its own responsibilities, such positions are unlikely to have more than moral force. For example, the Interim Committee of the IMF has made strong and repeated statements about the need for avoiding protectionism, but these statements have not prevented protectionism from growing by leaps and bounds.

Since the countries holding the largest shares of weighted votes in the Breton Woods institutions are unlikely to agree in the near future to any change in the weighted voting system, the question arises whether institutional arrangements might be created to permit joint examination of interrelated problems, without any material change in the system of weighted voting.

It must be admitted that institutional rigidities are a serious obstacle to progress in this area. Formidable problems are posed even by institutional coordination between the Bank and the Fund, let alone the further coordination that is needed with the institutions having responsibility for trade, In retrospect- the American Bankers' Association in 1944-45 was probably justified in calling for the Bank and Fund to be established as separate departments of a single institution. By now such a merger seems out of the question and might well raise more problems than it would solve.

There are three options for dealing with this problem. One strategy, occasionally favored by some of the OECD countries, would empower the interim Committee to take over broad policy responsibility for settling questions that involve two or more of the related issues of money, trade and finance. In that case. governmental representation in the interim Committee would have to cover trade as well as money and finance. A second option would be to vest such responsibility in the United Nations General Assembly, with the proviso that the Assembly would only have the power to make recommendations to the agencies concerned, while the final decision-making and executive authority would remain with each agency separately, within its sphere of competence. The third and perhaps the least realistic option would be to create a new super-decision-making body with some form of weighted voting, possibly along the lines of IFAD if not those of the Breton Woods institutions.

**VOTING POWER**

Developing countries have for many years been urging that they should be given greater weight in the international decision-making process on money, finance and trade. Their present goal is to acquire SO per cent of the voting power in the Breton

Woods institutions. Such movement as has taken place towards this goal in recent years has been almost entirely the result of the increased financial and hence voting strength of oil-exporting countries. The position of other developing countries has changed little. Moreover, the very latest developments have been-from the standpoint of the Third World-retrogressive.

r, In principle the developing countries have a collective veto on all decisions in the Bank and Fund that require a special majority of 70 per cent or more of the total voting power. However, since the combined vote of developing countries amounts to less than 40 per tent of the total, such a veto would require a large majority of developing countries to be in agreement on the subject at hand. Moreover, even where developing countries are in agreement, they hesitate to make use of the collective veto, fearing to offend the major countries, on whose benevolence they depend in times of balance-of-payments difficulties. Finally, the fact that a group of countries in a collective minority can prevent a certain decision from being taken does not mean that the group can impose the decision that it favors. At best it may be able to barter votes on different issues to obtain concessions.

Despite these weaknesses, the developing countries have, on rare "occasions, been able to press their point of view successfully. Perhaps a outstanding case was that involving the principle of universality sthe distribution of SDRs, an issue that was in contention in the late 1960s, At that time a firm and united developing-country position, coupled with the skillful diplomacy of a courageous Managing Director (Pierre-Paul Schweitzer), ultimately persuaded the Group of Ten to reverse itself on a major issue before the Fund. The establishment and progressive improvement of the Compensatory Financing Facility were other significant results of developing country influence. Developing countries also contributed to the suspension of discussions on creating a Substitution Account.

Decisions taken by the Fund in February 1983 were a setback to the developing countries seeking greater influence on the decision-making process. While the loss of voting power resulting from the Eighth Review of Quotas may have been relatively small in the aggregate, it was a perverse change of direction, from their point of view.

More serious still were the provisions agreed upon for activating the General Arrangements to Borrow (GAB). Activation was to depend (a) on a finding by the Managing Director that the Fund's resources were inadequate to deal with expected drawings by no participants, and that an exceptional situation existed associated with balance-of-payments problems of a character or size that could threaten the stability of the international monetary system; and (b) on acceptance of the Managing Director's findings by GAB participants and subsequently by the Executive Board of the Fund. This procedure was to create a two-tier decision-making process, one tier consisting of a limited group of Fund members. It may he noted that GAB participants already dominate the Executive Board by virtue of their combined weight in the Board's voting structure. The question arises whether such a two-tier system would be compatible with the Articles of Agreement, under which it is the Fund, and the Fund alone, that has responsibility for determining whether there is a threat to the stability of the international monetary system and for judging the adequacy of Fund resources. Indeed, GAB members have strenuously resisted efforts to endow the General Assembly of. the United Nations with even a limited power of inquiry into the functioning of the international monetary system, on the grounds that this is the exclusive prerogative of the Fund. The same logic is applicable to interference of GAB members themselves with that prerogative.

Clearly there were and are alternatives to the GAB. The first, and by far the best, is an additional enlargement of quotas in an amount.r

corresponding to the additional usable resources made available by the enlarged GAB. A second best alternative is IMF borrowing from the private market. As it now stands, the rate of interest on Fund borrowings from GAB members would be

a market-related rate equal to that paid by the Fund on holdings of SDRs. Thus, Fund borrowing from the private market would be clearly superior to borrowing from GAB members, because while the interest rate payable would be little if any higher than on GAB loans, the integrity of the Fund and of its decision-making process would be unimpaired. For this reason there is a good case that the Fund should not seek activation of GAB unless it is refused permission to borrow in the private market.' One advantage of authorizing the Fund to borrow in the private market is that it would give the Fund a greater capacity for initiative in dealing with balance-of-payments problems and greater discretion in deciding on the volume of resources required in coping with cases of international disequilibrium.

## CAPITAL CONTROLS

A major shortcoming of the present international monetary system is that private holders of liquid funds are able to make short-term transfers across the exchanges in amounts that are beyond any single central bank's capability to offset. It is not necessary to assume that private holders have any interest in the destabilization of exchange rates. The mere fact that expectations regarding the future course of exchange rates shift from time to time is sufficient to prompt transfers among currencies in the interests of avoiding exchange losses. Keynes considered that government control over both inward and outward capital movements should be a permanent feature of the international monetary system. Although this view was not accepted by the United States, the Articles of Agreement of the IM F do contain a clause allowing members to regulate international capital movements so long as the requisite controls do not involve restrictions on payments for current transactions or undue delay in settlement of commitments.
be authorized to borrow in the private market. The fact remains that such controls as are now in force in the major industrialized countries have had little or no effect in preventing short-term and medium-term volatility in exchange rates. It is doubtful that significant progress towards more stable exchange rates could be made without some kind of agreement among Fund members regarding the circumstances in which concerted action to regulate capital movements would be taken. Any new proposal for tightening capital controls would, however, he controversial among Fund members, both developed and developing, and this may well .be the most important single obstacle to a return to greater stability , in the exchange markets. ,.

## A WORLD CENTRAL BANK?

Would the establishment of a world central bank responsible for global monetary management contribute to the solution of current difficulties in the international monetary system? It is difficult to resist the impression that this proposal does not solve the real problems that the international community faces, but tends rather to assume them away. The proposal is tantamount to saying that if only national monetary authorities would agree to subordinate their own freedom of action to the needs of global consistency, all would be well. But the point is precisely that national authorities do wish to preserve their own monetary autonomy so as to avoid, as far as they can, placing their economies at the mercy of shocks emanating from abroad, and so as to be able to maintain different trade-offs between policy objectives from those that other countries might prefer. For most countries, global consistency is not the most important policy objective, to which they are prepared to sacrifice other goals. In the pursuit of national aims, they are prepared to accept the penalties resulting from global inconsistency.
Thus a world central bank is inconceivable without a world government, which is

itself inconceivable in the world of today. This does not, of course, rule out an evolution toward a world central bank, for example through progressive additions to the authority of the IMF. But there is little sign of such an evolution at present. The IMF has much greater authority in relation to the weaker members of the international community than in relation to the stronger ones. The latter continue to settle their mutual affairs-insofar as they settle them at all-in small groups of ten or less.

## REFORMING THE IMF

Some of the most important criticisms that are made of the IMF by such bodies as the Group of Twenty-four are not the result of inherent deficiencies in the Articles of Agreement but of the manner in which the Articles have been interpreted and applied. For example:
(a) The inability of the IMF to influence the behavior of its major members and the reluctance of these members to use the resources of the Fund are the result of the policies of the countries concerned towards the Fund and not of particular provisions of its constitution.
(b) The failure to secure an equitable sharing of adjustment burdens as between surplus and deficit countries results not from institutional shortcomings but from the inherent strengths and weaknesses of surplus and deficit countries. The Articles do in fact contain provision for strong sanctions against "scarce currency' countries-sanctions that have never been invoked. Possible refinements of the sanctions along the lines discussed by the Committee of Twenty might be helpful, but the main difficulty is not an institutional one.
© Failure to adjust conditionality to the circumstances of particular cases and, in particular, to provide low-conditional accommodation in cases (other than those covered by the Compensatory Financing Facility) where deficits are due to factors beyond a country's control is the result of the particular manner in which the Articles of Agreement are applied. A different approach could be adopted without any amendment of the Articles. There is, for example, nothing in the Articles that compels the Fund to insist on deflationary demand management even in cases where balance-of-payments deficits are not attributable to excess aggregate demand.
(d) The inadequacy of SDR creation is, if anything, an infringement of the Articles of Agreement, which clearly provide for the SDR to become the principle international reserve asset.
Reform of the IMF would require changes in the above policies and practices, which may or may not be termed "institutional" changes. A number of other changes in the functioning of the IMF are also worthy of consideration:
(a) Recent experience has thrown doubt on the legitimacy and efficiency of balance-of-payments support by commercial banks. v The fact that the IMF has had to bring strong pressure upon the banks to cooperate in dealing with the debt crisis in a i manner acceptable to the international community indicates that the motivation and objectives of the banks could, in times of crisis, lead them to act in a manner that would be disruptive of internationally agreed policies. Even now, despite IMP pressure, the total volume and terms of balance-of-payments support available depends (not unnaturally) on the judgment of commercial banks as to their own best interests, rather than on a judgment of what is best for the countries concerned and for the international community as a whole. The fact that the interests of the banks and of the borrowers may at times coincide provides no assurance that they will always coincide or that the terms of agreement between the two sides will be optimal from the standpoint of the countries concerned. There is therefore a strong case for rebuilding the resources of the IMF, so that it can reclaim the task of balance-of-payments financing from the commercial banks and thereby regain the importance that it had during the 1950s and 1960s.
**(b) This rebuilding process should also restore and enhance the**
array of resources provided by the Fund so that its operations would include the

entire spectrum of lending, from low-conditional to high-conditional. In particular, the Fund should include countercyclical balance-of-payments support as one of its major activities. Current efforts to curb the Compensatory Financing Facility and raise the level of conditionality appli
Cable to it are precisely the opposite of what is needed. a
© Drawing rights on the Fund should be less rigidly tied to quotas. One way of achieving this might be to liberalize the waiver provisions. 'ii?'
(d) Even as regards high-conditional lending, the Fund should he .
less "grandmotherly.° The Fund cannot and should not super, vise the running of national economies, which involves political and social as well as economic accountability. The Fund evaluations of its own programs indicate a failure rate sufficiently high to warrant considerable caution regarding the capacit of an international organization to prescribe workable a acceptable domestic policies for countries. The Fund sho address itself much more to balance-of-payments targets than to domestic policies, and the performance of borrowers should be judged much more in terms of balance-of-payments results than in terms of the domestic policies pursued.
Finally, it is necessary to strengthen the provision for mediumterm and long-term balance-of-payments financing. The Fund considers that it already has adequate arrangements for medium-term financing in the form of the Extended Fund Facility (EFF). However, there are problems with this facility, as is indicated by the limited and declining recourse to its provisions. A major defect of EFF is that it provides only for high-conditional lending, whereas there are many cases in which medium-term financing of a lowconditional character is called for. This is particularly true in circumstances of protracted cyclical downturn. It is improper to insist on strong programs of adjustment in cases where countries are facing temporary and reversible deficits due to recession in their main
export markets. Such a policy contradicts traditional Fund doctrine, whereby temporary and reversible deficits should qualify for financing without adjustment .As regards long-term balance-of-payments support, the Bretton
~. Woods arrangements limited the Fund to short-term financing and placed responsibility for long-term balance-of-payments programs in the World Bank. An early decision of the Executive Board of the World Bank approved the report (R-2g) of its Committee on Interpretation, which concluded that "Under the Articles of Agreement, " the Bank has authority to make or guarantee loans for programmes of economic reconstruction, and the reconstruction of monetary systems, including long-term stabilization loans." In practice the :World Bank never acted on this mandate, unless it is considered that ,program lending should be included in this category. More recently the Bank has introduced a program of Structural Adjustment
~'i:ending which has the character of balance-of-payments support,
',ot the scale of the program is very limited, and there is no itionality in the resources provided. The case for long-term stabilization loans in appropriate cases was loped at the time of Bretton Woods by the American Bankers'
ctafon, and was accepted by the United States, United King and other governments. It is no less valid today.

## THE DEBT PROBLEM

In the area of debt, it is relatively easy to make a case for new L institutional arrangements, if only because existing arrangements are so obviously makeshift and lacking in coherent rationale. That does not mean, however, that new institutional arrangements would be more acceptable to the international community in this field than in other fields.
There is a remarkable contrast between the treatment afforded to debtors faced with difficulties at the national and international levels. It has been found

necessary at the national level to provide strong protection for debtors against the possible onslaughts of overanxious, - overzealous, or over greedy creditors. In the United States, under chapter I I of the Bankruptcy Reform Act of 197g, provision is made for judicial review of plans for reorganization negotiated between creditors and debtors. Standards are laid down to guide judges in deciding whether particular plans of reorganization should be confirmed. These standards include, for example, a requirement that plans of reorganization shall be "feasible" in the sense that they are not likely to be followed by a need for further reorganization. Judges are endowed with broad equitable powers, and in evaluating "feasibility" may decide whether the schedule of payments and the associated charges are consistent with the purpose of the reorganization.

At the international level there is no strong judicial or even quasijudicial authority responsible for assessing the "feasibility" of programs of rescheduling in order to avoid a subsequent repetition of rescheduling. Although the guidelines for the rescheduling of official debt explicitly require a comprehensive analysis of the medium-and long-term dimensions of a country's debt problem and a solution which would enhance its development prospects, the approach adopted in practice is essentially short-run. Consolidation periods have invariably been short, seldom exceeding 18 months. Far from avoiding repeated reschedulings, official rescheduling agreements Irequently provide for reexamination of a country's needs following the expiration of the first consolidation period. No provision is made for minimum standards of treatment that would permit a minimum rate' of growth to be restored or maintained. The rescheduling of commercial bank debt is even more ad hoe and even less far-sighted than that of official debt. Both official and private creditors at the international level seem to be much less aware of their own best interests than at the national level, where it is recognized that a debtor who is allowed sufficient breathing space to restore the viability of his enterprise is more likely to be able to effect repayment than a debtor who is driven to the wall.

Much of the difficulty at the international level comes from the lingering idea that every case of debt crisis is unique and cannot be compared with any other case. Consequently, the view prevails that no general conclusions can be deduced and no minimum standards of relief applied. Indeed, it is said that the very exercise of drawing up general principles and minimum standards would encourage countries to seek relief in circumstances in which they were not entitled to it. In a study titled "External Debt of Developing Countries" published by the OECD in 1981, the conclusion was reached that "there is no generalized debt problem calling for generalized solutions: acute debt-servicing difficulties have remained exceptional, have affected only a few countries, and have been efficiently dealt with on a case-by-case basis through multilateral debt renegotiation."

Never, perhaps, has the creditor case, thus stated, and been as weak as it is at the present time. The idea that every debt crisis is a unique event is increasingly difficult to sustain in the face of the multiplicity of such crises since 1980. So tong as crises were relatively few and far between, it was possible to argue plausibly that they were due wholly or mainly to the improvidence or mismanagement of the debtor countries concerned. But from 1980 to 1982 no less than 40 countries were compelled to seek the rescheduling of their debts, and it could hardly be maintained that each and every one of these 40 cases was "exceptional."

**Not merely did the 40 cases have many more similarities than**

differences, but most of them were largely due to factors outside the
control of the debtor countries concerned. The fact is that during the r, period from 1980 to 1982 the creditor countries ff:

(a) applied macro-economic policies to counter inflation that had the effects of reducing the volume of demand for imports from the debtors and of driving down the prices of commodity imports to their lowest level in real terms for the past thirty

years;

’ **(b) imposed protectionist restrictions on imports from the debtors; and**

adopted a mix of policies that had the effect of forcing up
interest rates to exceptionally high levels, thereby raising debt service obligations on floating rate debt to an extent that could not have been foreseen at the time the debts were contracted.

Thus the creditor countries were responsible for measures that inflated the debt service obligations of the debtors at the same time as they were eroding the capacity of the debtors to meet those obligations. The effects of any mismanagement by debtors -and it are undeniable that such mismanagement occurred- only supplemented the primary sources of difficulty enumerated above.

The lack of a rational policy framework for the treatment of debtors encountering difficulties is reflected m an extraordinary diversity of experience. In a few cases debtors have received liberal treatment, with substantial lengthening of maturities and low rates of interest. An outstanding instance of such liberal treatment was that of Indonesia in 1970: the country’s entire debt since 1966 was rescheduled over a 30-year period at no interest, and provision was made for still further postponement if this was warranted by balance of-payments considerations. In sharp contrast to that instance, most countries compelled to reschedule today confront relatively short amortization periods even for official debt and interest rates that are usually at market levels or (for commercial debt) higher. Thus, generally speaking, only a minimal amount of relief is granted, on the theory that only a short leash will stimulate the debtor to take the drastic action needed to correct the errors that he has made, preferably in the context of a stabilization program approved by the IM F. Of course, where the predominant reasons for a debt crisis are external, the short-leash approach—which does nothing about the external pressures on debt servicing capacity does not give sufficient relief even to strengthen domestic performance, so that the crisis is likely to recur in short order.

It would probably serve no useful purpose to create a new institutional framework unless there were a corresponding change of creditor country policies, permitting, in particular, the application of minimum standards and norms, and recognizing that debt relief should be such as to permit resumption or continuation of a minimum rate of growth. Since the prospects for such a change of policies must be considered poor at the present time, there is little point in envisaging a specific institutional structure. By the time a change in policy does take place, the existing institutions will, of necessity, have evolved further.

One point that is frequently overlooked is that the Breton Woods institutions, competent and useful as they are in this field, cannot avoid the potential conflict of interest that results from their own status as major creditors. Moreover, the World Bank has not thus far been prepared to have its loans included among those eligible for rescheduling. When the time comes, a new forum with its own constitution will probably be needed.

Some recognition of the need to define minimum standards of appropriate behavior by creditors has recently emerged in the United States Congress. Both the Senate and the House of Representatives have proposed that fees charged for rescheduling a commercial bank loan should be collected over the life of the loan rather than all at once. And the House has proposed that a limit should be placed on fees for rescheduling and that excessive bank profits from interest charges should be taxed. These proposals implicitly recognize that the charges made by the banks for rescheduling operations are apt to be excessive. Here at least is an area where there is need for a clear definition of minimum standards of performance by the banks.

## A GATT FOR FOREIGN INVESTMENT?

The lack of a regime for foreign investment is a subject of frequent comment. The first Brands Report recommended the adoption of a regime that

would include reciprocal obligations on the part of host and home countries, covering foreign investment, transfer of technology, and repatriation of profits, royalties and dividends; legislation, coordinated in home and host countries, to regulate transnational corporation activities; intergovernmental cooperation in regard to tax policies and the monitoring of transfer pricing; and the harmonization of fiscal and other incentives among host developing countries.

More recently, from a somewhat different point of view, the Business Roundtable of New York, in its Statement entitled "Inter ; national Investment: A Plan for Action" expressed the view that *, there was a need for "a comprehensive multilateral agreement on investment" that "should he binding and include dispute settlement procedures similar to those used in the GATT." It suggested further that since a GATT for foreign investment "is not feasible in the short '.krm" the United States should pursue investment-related work
programs and negotiations along existing avenues in the OECD. World Bank. 1MF and GATT (no mention was made of the United Nations), thereby developing the consensus needed for a General Agreement on investment.

It is well known that foreign investment has been the subject of frequent disputes not only between private foreign investors and the countries in which they invest, but also between home and host countries, since the former are concerned to ensure that justice is done, as they see it, in respect of the property rights of their nationals; while the latter stand on the principle that property rights within their own borders must he subject to whatever disciplines domestic law and domestic government policies may prescribe.

GATT has a mandate to try and resolve trade disputes between its members in terms of the basic instrument that sets out that mandate. The only multilateral counterpart in the field of foreign investment is the International Center for the Settlement of Investment Disputes (ICSID) which has a limited mandate and which is not universally accepted as a forum for dispute settlement.

GATT can, however, become involved in areas closely related to foreign investment to the extent that government measures relating to investment impinge on trade. One such area is that of performance requirements- whereby host countries seek to influence the extent to which local affiliates of transnational corporations make use of domestic sources of supply for inputs into the production process. or whereby they try to increase the proportion of goods produced by these affiliates that is exported. A landmark decision in this field involving Canada and the United States was published by GATT in July 1983.

The United Nations has been negotiating a Code of Conduct on Transnational Corporations for a number of years. Although considerable progress has been made towards an agreement that would prescribe responsibilities for host countries as well as for trapsnational corporations, some important issues are still outstanding. Failure to conclude the negotiations may have contributed to growing recourse to bilateral agreements on foreign investment between pairs of industrial and developing countries. But bilateral arrangements are no substitute, in the long run, for a multilateral framework, as the experience of GATT in trade matters has clearly shown:' The bilateral route is full of anomalies, inconsistencies and inequities, and is unlikely to satisfy even the home countries in the long run, if,
only because bilateral arrangements that are unduly favorable to one side are likely to prove unstable and unenforceable. There is therefore a strong case for a multilateral regime, under United Nations auspices, building on the Code of Conduct now under negotiation.

# CHAPTER 24
# Institutional Reform:
# Economic and Political Issues*
**Michael M. Sakbani**

Reform of the international monetary system has been the subject of much debate and many proposals in recent years. The difficulty in achieving the needed reforms is thus no longer one of exploring uncharted waters, but rather one of putting together a consistent program of reform that takes into account the substantial changes wrought in the world economy during the past two decades. This paper attempts to portray these changes in four ways: it points out the interrelation of money, trade and finance in the operation of the international economic system as has been evinced in the 1970s; it seeks to identify the major changes in the underlying conditions of the world economy and to evaluate the present relevance of the basic assumptions of the postwar international system; it highlights the role of the changed economic policies of key states as well as their political interest in the system; and finally, it brings out the concerns and particular problems of the developing countries in the inter national system.

After first clearing away some of the political and economic arguments pertaining to the feasibility of the reform exercise, 1 next explore the assumptions and underlying conditions of the Breton Woods system, then examine the crisis of the system in the light of the events of the 1970s and early ‘Sops, and finally, offer preliminary reform proposals regarding some aspects of the existing system. The approach I have taken is one of system reform rather than system overthrow. It is an approach rooted in the political realities of our time, in particular, the inequality of economic powers of states, and the necessity to find a viable quid pro quo in any reform proposals aimed at intergovernmental action.

## I. THE FEASIBILITY OF REFORM

It has been argued that the key countries do not now have the political will needed for important reforms in the international sys tern, in part because of domestic preoccupation and in part because

*This is an abridged version of a longer paper presented by the author. [Ed.

of a dearth of strong and committed leadership by a major state or a coalition of states who find it in their interest to push for reform. Another line of political skepticism emphasizes the zero-sum nature of system changes; in this view, system reform will inevitably shift power from the advantaged of the prevailing system, the developed countries, to the relatively disadvantaged, the developing countries. Another argument is that system changes in this epoch concern political power distribution more than economic interests.

These arguments are no doubt powerful and plausible. However, they chiefly stand on an extrapolation from the present political circumstances, whereas political will is constantly subject to change. Furthermore, while a full appreciation of political feasibility is essential for any reform proposal, it is equally essential that all analytically sound proposals be voiced, regardless of the apparent short-term political feasibility.

To be sure, reform is likely to entail redistribution of power in favor of the weak. However, insofar as the reforms set rules of conduct, they will help depoliticize the system; and any loss of sovereign control by the major countries in the reform process would be partially offset by their undoubted preponderance in decision

‘ making in the strengthened international system. In fact, it can be argued that a

strengthened international system would encroach i upon the sovereignty of its members, giving greater control to the big 'e states-that a weak and ad hoc system allows more freedom of action for all. However, a weak system also probably offers its 'members smaller benefits, which for weaker countries may be more significant than the degree of freedom.
It is true that a leadership role such as that taken by the U.S. in ˉ'the postwar era is not likely to be assumed by any one state or ?:-noalition of states at this juncture. Nevertheless, because of current rtoblems in money, trade and finance, it may prove to be in the ~!ng-term interest of major states to seek resolutions by way of ':+y 1cm reform. rent Economic Conditions nder the current crisis of debt, it does not seem likely that the ;national system will weather the problems of the 1980s, even ad hoc support measures such as those put in place early in i. A real income growth rate of 4 to 5 per cent per year over the . pm term is probably the upper limit of a reasonable forecast for growth in the developing countries for the mid-1980s, which with an expected annual rate of international inflation of 5 per cent, translates into 10 per cent annual increase in nominal debt-bearing capacity compatible with structural solvency- This rate of growth happens also to be about what is expected for the expansion of bank capital) which means at least a 50 per cent average reduction in new commercial financing during the years to come. Consequently, the sustainable and likely level of new commercial flows far many i countries may be less than the amount of their interest payments, assuming a future level of interest rates of at least 6 to 8 per cent. Thus, on the basis of short-term calculations, the shortfall may make default a rational choice for some countries. Therefore, in order to ; save the international system from disaster, a range of new arrangements-monetary and financial-including the involvement of new private and official sources of finance, must be worked out. Otherwise, temporary and ad hoc measures will be needed continuously to stave off frequent stresses and crises. The fact that the 1983 rescue operations seem to have been successful is not at all a guarantee that
a financial crisis will not occur in '84 or '5. The financial obligations, of the developing countries and their need for resources for growth are simply larger than the temporary financing such rescue operations can bring.
The international reserve system, based as it is on the U.S. dollar, is likely to continue to operate with little regard to international considerations and with the same irregularity it has had since the mid-)960s. The large projected U.S. budget deficits and the need therefore to borrow from abroad, the operations of transnational banks, and international portfolio-management decisions will be the main factors behind reserve expansion in the 1980s. None of these forces is driven by the requirements of international liquidity Orr bound by the responsibility to manage it in the interest of stability or in accordance with evolving world economic conditions. The result will be an uncontrollable expansion of U.S. external liabilities and shifts in capital flows, engendering instabilities in exchange rates and posing severe economic management problems for many countries.'

'See the remarks of Governor H. C. Wallace of the Board of Governors of the U.S. Federal Reserve system at the Annual Conference for U.S. Commercial Bankers, Washington, D.C... IS February) 9R3 (Bank of'
Thus, in all these areas-finance, money, and trade-the absence of full-fledged reforms will not prevent change in the international system, but will only mean that such changes will occur outside of
C any consistent framework and without planning and cooperation.
Some Realistic Charnel eristks of System Reform The task of reform, in my view, is not to bring about world economic management in the full sense. Rather it is to construct an international system characterized by a coherent structure of international economic relations, leaving ample room for the internationat operation of private markets and enterprises (state as well as private). The inherent difficulty of controlling international markets,

• as well as the considerations of efficiency and equity, militates against a high degree of management. Thus the concept of manage "i meet should be used in the sense of active participation by govern s ments in steering the world economy towards agreed aims, through a .. Process of consultation, surveillance and follow-up. Such a system ,'would provide an infrastructure allowing growth and efficient operation to proceed and would afford incentives for directing resources to 'certain areas. More international management might apply to certain t greed areas having the characteristics of a "public good"" for ' stance, research and development, environmental protection, ener
i and food development and exploitation of commons.
A reformed system in today's world must conform with two requisites: it should involve a degree of sharing in resources,
ieularly common global resources, and it should allow for etpatory democracy through representative management. How there may be a trade-off between these two. If the reformed
is to be endowed with sufficient resources, the major members will demand a share in decision-making commensurate with their provision of resources. These two prerequisites, then, must be harmonized through modalities which, while allowing every state to express itself on any problem, invests decision-making in the hands of a limited number of members, subject to the checks of an international democratic process. The quid pro quo will be in the form of increased resource-sharing among members.

## IL BACKGROUND OF THE PREVAILING INTERNATIONAL ECONOMIC SYSTEM

### Origins

The present international economic system, going back in its
origins to the period immediately following World War II. was fundamentally influenced by the events of the 1930s, and therefore can be seen as the expression of a collective will to create a framework for avoiding the economic nationalism of the 1930s, with its beggar-thy-neighbor trade and payments policies. The system was also designed to reduce the uncertainty and instability of the trade
And financial markets and to promote a multilateral, open and nondiscriminatory trading system. Each of the system's main components-trade, money and finance-while interrelated in operation, was conceived to run on a separate track: the [ME, the IIIRD and the unrealized ITO. And the liberal democracies strove to depoliticize ?' the system's operation somewhat by establishing a code of rules in its charters. For political and economic reasons, the East European socialist countries did not join the Breton Woods system.
The membership of the Bretton Woods system was predominantly from the developed market-economy countries (DMECs) and the independent developing countries of Asia and Latin America. In its - = assumptions about the world economy, the system naturally reflected '~ the conditions, interests and views of the Dames, which were members of a political alliance led by the United States and enjoyed , a high degree of political and economic homogeneity. Perhaps; because of this political and economic convergence, the founders of. The Breton Woods system thought an attitude of flexibility under- : pinned by political good-will would be sufficient to assure the viability-' tee and acceptability of such a multilateral undertaking. Thus many of the inadequacies subsequently found in the system may be laid to the changed political will of the main members, the diminution of~
their economic capacities, and their preoccupation with short-term and domestic

concerns.
As the principal member of the Breton Woods system, the U.S. was assigned an implicit "banks role"; its currency was expected to become the system's principal form of foreign exchange. This implicit banking role ensured European acceptance of the U.S.-sponsored design of free trade and enabled the financing of substantial and badly needed U.S. exports to the devastated European economies. Thus the postwar configuration of economic interests and capacities both served the DMECS' economic interests and met their concerns about political stability.
Over the next two decades, however, many of the favorable factors underwent significant changes. In the 1970s, such changes became substantial enough to vitiate the underlying assumptions of the international system. To appreciate the extent of those changes, it will be helpful to review briefly the political and economic conditions which underlay the Breton Woods system.

**The Postwar Economic Environment**

The economic environment of the postwar years was characterized by healthy investment rates in all DMECS-domestic savings supplemented by large doses of external financing. In rebuilding their economies, the DMECS had available to them a considerable stock of technology accumulated largely in the United States. Therefore their rebuilt industrial structures were perforce adapted to state-of the-arts technology, a circumstance which underpinned their strong gains in productivity through the early 1970s. Furthermore, the DMECS had access to abundant manpower and cheap energy, and the United States easily supplied the needed capital and industrial goods.
Another important factor in the postwar growth of the DMECS was the considerable room for growth in public expenditure. The share of budgetary claims on gross domestic product (GDP) was L, quite modest: still below 32 per cent in 1961 for seven major industrialized countries. This was in part due to low levels of social °.expenditure, in particular entitlement programs, and in part to low ',levels of armament expenditure on the average. Thus fiscal policies were not hampered by structural budgetary rigidities, and the cynesian demand-management tools were given a full and on numbered scope at the national level. Such macroeconomic policies
Brought unprecedented economic growth and prosperity to all countries at hardly any immediate cost. Furthermore, international trade and investment stimulated the prosperity of many countries.
This economic vitality on the domestic level of the Dames was internationalized by the Breton Woods system, and in the process, benefits accrued also to the developing countries. Not only was the trickle-down process in effect in the 1960s and early 1970s, but also significant steps were taken in this period towards an international consensus on development. The development targets of the U.N., the aid extended by Dames to developing countries, the recognition of the special problems of developing countries in the GATT, the GSP, and the significant changes in the IMF and the IBRD are outstanding elements in this consensus.

## III. THE SYSTEM CRISIS

By the early 1970s, cumulative changes in the economic environment and in the political and economic relations which anchored the Breton Woods system had their impact on the relevance and efficacy of its institutions. In view of the increased interdependence of the world economy, the separate tracks within which the various Breton Woods institutions operated became unsuitable. Moreover, the economic crisis unfolding in the 1970s taxed the capacities of the multilateral system and moved beyond the scope of the Breton Woods vision.
One important change was a gradual diffusion of economic and political power, as Japan and the various European countries rebuilt and modernized their economies.

From a position of dominant power, the U.S. economic capacity declined in relative terms to one of primus inters Paris. In 1955, the U.S. produced 40 per cent of world output, but by 1980 their share had fallen to only 24 per cent. In total world trade (excluding the socialist countries), the U.S. share (in current prices) declined by roughly a quarter over the same period. And the influx of developing countries into the international economic system considerably changed its political complexion. Hence, the homogeneity of political and economic interests, which had previously underpinned the system and filled in its institutional gaps, no longer held. The increased importance of developing country members in lhd Bretton Woods system intensified the demands for reform, specifically'
To give development a more central position and to expand the share of developing countries in decision-making. Moreover, without as much access to other economic resources, the developing countries placed substantial demands on the system's own resources. Hence, the inadequacies of these resources and of the .system's commitment to deliberate development were exposed clearly, and the issues and demands involved have come to constitute the agenda for the North South

Dialogue and the theme of the new international economic order (NIEO). The North-South dialogue has faced its greatest difficulties in the North-South divergence of political views and economic commitments to deliberate development.
The long-ton economic forces which made the 1950s and 1960s a period of sustained growth and widening prosperity are another factor that underwent change. By the early 1970s, the large discrepancy between the United States and Weston Europe in productivity and technology had disappeared. Then, in the 1970s, there was a decline in the overall productivity growth: from a rate of 4.5 per cent during 1960-76 to 1.7 per teat during 1973-76 and to only 0.6 per cent in 1980. In the slow growth environment of the 1970s, the social and economic conflicts which the previous economic buoyancy had concealed or postponed came to the surface. In particular, the power of labor to claim increases in income based on past high-growth trends and the tendency of governments to swell their expenditures on armaments and social entitlement programs created an inconsistency between the consumption trend and the level of investment in the productive structures necessary to maintain it. Accommodative monetary policies enabled producers to pass on cost increases beyond productivity gains through inflation. Since the savings-investment deficiency (relative to the consumption trend) was not relieved by productivity gains in existing industries or by a structural shift to new and more productive investments, the result was stagflation- the anomaly of the 1970s.
The prolonged recession of the DMECs, coupled with growing social and armament demands on public budgets, placed new financial constraints on the DMEC governments. Budgetary claims on GDP in seven major industrialized countries went up from 32 per cent in 1961 to 36 per cent in 1973 and 41 per cent in 1980. The total of transfer payments in relation to total budgets rose in the Federal Republic of Germany, the United Kingdom and the United States from about 41 per cent in 196l to 48 per cent in 1980, and in France to about 49 per cent. The new financial constraints necessitated a F reordering of priorities. In some countries. official development s assistance (ODA) programs, an important element in the develop- r, ment consensus of the 1960s. became a victim of these changes.

**The Retreat from Economic Activism**

The account of changes in the underlying forces would be lei incomplete without a brief discussion of changed attitudes and policy
Constraints in the developed countries. In the postwar era- demand- a, management policies, modeled on Keynesian precepts, dominated
Macroeconomic thinking. In the high-growth decades of the 1950s B
And 1960x, these policies in conjunction with favorable underlying sty

Forces buoyed up the DMEC economies. But as the long-run forces Changed, these policies no longer guaranteed success, partly because Of a variety of rigidities: in economic policy-making, in budgets, and In wage determination and industrial structures. It is now widely Acknowledged that Keynesian demand-management is not in itself Adequate for dealing with crises marked by sect oral supply con- and structural cost-push factors. Moreover, the political

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Commitment to full employment, when not accompanied by limits to of income-share gains and continuous readaptation of capital structures -IN and labor resources, proved to be a one-way road to inflation. . <Mi

The appearance of stagflation from 1973 onwards marked not. ." Mt only the economic conditions of the decade but equally the assess-. = "fin

Meet of the economic policies of the previous two decades. Whatever Caused the policy failures, economic "activism" nationally and, '»Internationally was undermined in the eyes of policy-makers and in Public opinion. Governments retreated towards unilateralism and Experimentation with new and non-activist policies. While some of. The new precepts have undoubtedly filled some gaps in the demand? management policy mode}. They have proved unsuccessful in pull the world economy out of crisis.

The St'srern in Crisis: An Evaluation

The cyclical downturns in the Dames, superimposed on the Ion run changes, produced a widespread economic crisis which grew' severity as the 1970s ended. Although there are now important is of improvement in some of the major industrialized countries, t signs are still limited to a few economies and are plagued C significant weaknesses. Nevertheless, the recovery should ease

political decisions on a thorough examination of the international system. The biggest mistake would be to neglect the issues of system reform because of recovery.

The major shortcomings revealed by the crisis of the '70s and early 'Boss are the compartmentalized working of the system, some specific weaknesses in the subsystems of money, trade and finance, and the economic policies pursued by the major members.

a) interdependence and the system's compartmentalization

Compartmentalization was embedded in the institutional design of Bretton Woods. With the failure to establish the ITO-the constituent with the broadest and most active macroeconomic mandate-the other institutions with narrower focus built up their mandates and policies in complete independence. But by the 1970s, it became clear that the compartmentalization ran contrary to the growing reality of interdependence. The payments, trade and financial problems of the 1970s proved resistant to quick partial solutions; fundamental disequilibria were evinced in most macroeconomic

," variables; and the growth of capital markets altered the relationship of finance and trade. Yet the institutions of the system proved incapable of taking an overall view of the multifaceted crisis or initiating coordinated solutions. There were few mechanisms for intergovernmental coordination encompassing trade, money and finance. Instead, each institution prescribed its own medicine within its narrow sect oral concern. For example, in the middle of the global recession of 1980-82, the IMF advocated deflationary adjustment to all members seeking financing from it, even though at that time the ability of a member to adjust was clearly and critically dependent on exporting more to markets already in a state of slump. This situation could be seen in some Latin American countries, including Brazil, in late 1982 and 1983.

**The crisis of the 1970s brought the interaction of money, finance**

- And trade into sharp focus. The void created by the resource limits

Tins of the monetary system were filled by the international financial System in the form of large commercial loans, used often for general

Purpose support. In turn, in this process of credit extension, the
manila system depended on a healthy performance of the trading -tern, which was not forthcoming in the context of recession and
.ternary macroeconomic policies.
::^:.The working of the adjustment process in the 1970s depended,
infer alias, on the evolution of the trading system. The introduction of ‘ trade restrictions, especially quantitative controls and variable import levies, made it impossible to realize the full potential of balance-of payments adjustments through the growth and diversification of exports. The international trade system left the door ajar on a variety of trade restrictions, some based on payments grounds, but the international monetary system simultaneously insisted on prompt payments adjustment. In other words, while the GATT system allowed exceptions for balance-of-payments purposes, the IMF frowned on the use of commercial policies in adjustment. Since the countries which faced this were usually minor trading powers in need of IMF funds, the inconsistency between the trading powers and monetary system fell on the deficit countries with no power of retaliation in the trade sphere.
Another aspect of interdependence can be seen in the relationship between exchange rate depreciation and trade. While exchange rate depreciation may be a weak adjustment mechanism, it is still an instrument for balancing the current account over a sufficient period of time. However, in the absence of an effective policy-surveillance role for the central institution, there is no guarantee that devaluations or depreciations will not be matched by trade competitors or - vitiated by quantitative import restrictions imposed by trading partners.
The debt problems which assumed crisis proportions in 1982 were another manifestation of this interactive dependence of the various spheres. The borrowing countries chose to blend financing and trade ,. Adjustment (compression of consumption imports and expansion of exports) in dealing with their large payments deficits from 1974
onwards. This choice was predicated on the assumptions of con-s tenuous growth in trade, modest debt cost and continued availability of bank finance. When the 1980 recession and its collateral restrictive, macroeconomic policies took hold, the demand for developing country exports, especially in manufactures trade, shrunk. At the same time, restrictive monetary policies pushed international interest rates to unprecedented heights, which escalated the service on debt’ transacted at floating rates and short maturities. The collapse of the markets for the manufactured exports of developing countries in, Dames was paralleled by a reduction of trade among developing countries, partly in consequence of the collapse of commodity terms’ of trade in 1981-82 (including oil prices). At this juncture, international banks, which had predicated their loans on the economic potential of the debtors and the dynamism of their export growth, revised their risk assessment, and in 1982 new bank lending fell 50 per cent from the pace of 1981. In short, the performance of the financial system depended on a healthy performance of the trade system, and the crisis in one reinforced the crisis in the other.
The interdependence of economic policies was also quite evident in the system crisis. After the shift to a deflationary stance by most DMEC governments in 1979-80. it became nearly impossible for any one government to follow an expansionary course on its own. France attempted in 1981-82 to stimulate its economy through fiscal measures and a new framework of economic management. However, the attempt was aborted because the financial markets and the demand for French exports did not respond supportively. France’s unilateral action resulted in an increased overall deficit, a weakening of its currency and severe loss of reserves. In 1982, both Japan and the Federal Republic of Germany had favorable payments situations, and both governments thought that there was room for stimulus to alleviate the unemployment problem and reduce slack capacity. However, both Germany and Japan had to keep their interest rates in line with the

high U.S. rates to avoid capital outflows and currency pressures, thereby undermining the revival of investment. In sum, the interdependence of policies both limited the efficacy of unilateral actions and narrowed the choices of governments. The conclusion to be drawn is rather straightforward: the international economy in its various aspects has become so interdependent that only cooperative multilateral efforts have a chance of succeeding.

b) Inadequacies in the subsystems

;, The international monetary and financial systems had to cope I:. from 1974 onwards with unprecedented payments deficits, shifts in
The composition of financial flows, gyrations of exchange rates,
'_. Unilateral and inconsistent macroeconomic policies, periods of
Synchronized global deflationary effects, persistent high rates of
"~ Flatiron and high rates of unemployment. To be sure, no system,
~waver well designed and adapted, could have coped easily with all 1-these ills. However, it must be ascertained to what extent these
[a] boles exposed basic shortcomings in the existing subsystems.
The principal weakness has already been suggested: namely, the
of effective mechanisms for policy coordination in the system. In the IMF, the Executive Council which was envisaged to take over a semblance of such a function has not come to pass, and the Interim Committee which now functions in its place has generally been ineffective as a forum for policy coordination, not least because it - lacks the wide mandate fitting the growing interdependence of money, trade and finance. Despite repeated calls by various governors (e.g.. U.S. governor Miller in Belgrade in 1979) upon the IMF to take initiative in this regard, the reality is that the principal members of the system have relegated whatever coordination of macroeconomic policies they deem necessary to their periodic summits and the Group of 10 and Group of 5 meetings. The problem is considerably worse for the developing countries, since the system has always considered macroeconomic management in the short run, with no regard to long-run growth.

Exchange rate volatility and unjustified currency valuations are another salient weakness of the prevailing monetary system. By any standard measure of exchange rate variation, the period after March 1973 shows a considerable increase in exchange rate volatility relative to pre-1971? Such volatility reflects short-term development engendering short-run capital movements and portfolio shifts in highly integrated financial markets with characteristic cumulative over-and undershooting. In the absence of a stable world enumerative, the evolution of exchange arrangements over the past few years threatens ' to lead to a multi-currency system. Such a system is conducive to the forming of trade blocks and to speculation and frequent currency
shifts? For these reasons, the exchange rate system has been the , subject of intense debate in Europe and the U.S., and these issues have been a driving force behind the evolution of the European
Monetary System as a defensive zone of stability among European~ trading partners. The payment adjustment process from 1974 to the present has not had a successful record. The response of the system has been marked by a deflationary adjustment bias, necessitated by the 1M F's inability to ,

[2]G. Berliner et al., The Impact of the Current Exchange Rate System on Developing Countries," Trade and Development Review, No. 3, Winter y 1981, UNCTAD, pp. 33 ff.

'Group of 30. "Foreign Exchange Markets under Floating Rates," a study in underfinanced by the Exchange Market Participants Study Group, 1980.

force adjustment on surplus countries. An overall deflationary demand approach is appropriate for situations in which payments difficulties are due to inflationary pressures of domestic origin, but since 1975, payment deficits in developing and developed countries were not largely demand-induced. The IMF's Annual Report

for 1979 noted that the entire increase in the balance-of-payments deficit of non-oil developing countries from 1977 to 1979 (estimated at $22 billion) was due to two factors: the deterioration in terms of trade and the rise in the cost of servicing external debt.4 A similar situation existed in 1981-82, when the external factors responsible for the deficits of the oil-importing developing countries were the collapse of the terms of trade, the recession-induced decline in export volumes, and the increased cost of servicing the external debt. Yet deflationary adjustment was prescribed, on the theory that disequilibria, if not manifestly temporary, should be corrected regardless of their sources

The conditionality attached to IMF funding was reconsidered in 1978 and 1979, and new guidelines were adopted in March 1979 concerning the use of the IMF's resources The time period for adjustment was extended for some facilities, and the supply side received more emphasis. But the deflationary approach remained intact, and while these new guidelines gave some heed to political factors, they remained silent on the critical question of the deficitcountry approach to adjustment. After the seventh general review of quotas, the new flow of IMP credits to non-oil developing countries increased threefold in 1980 relative to 1979 and increased again in 1981 relative to 1980; and the associated conditionality reflected more flexibility and willingness to finance deficits than beforel In 1982 and 1983, the Fund increased its commitments to deficit countries, but under toughened conditionality and with a full endorsement of deflationary correction as the solution for all.s Over the medium and long term, a persistent deficit must be corrected. However, the appropriate adjustment would emphasize

4See IMF, Annual Report (Washington D.C., 1979), p. 23.

3See B. Nowead, The IMP and Its Critics, Essays in International Finance,

Structural change in the economy-a change in its productive structures. The Breton Woods system has recognized the need to stretch out adjustment, as is shown in the liberalization of the Extended Fund Facility (EFF). The 1BRD also initiated a program of structural adjustment-the Structural Adjustment Lending Program (SAL). But the funds available are modest, and their conditionality involves considerable demand compression, on the theory that structural adjustment can only be effective where aggregate demand and, if necessary, external borrowing are limited? At any rate, positive structural adjustment policies are part and parcel of the evolution of the trade system, and the Imp's concentration on only short-term monetary and fiscal targets once again reflects its narrow sect oral approach. It should be noted that once structural adjustment and payments adjustments are linked, as is the case with the SAL program, the distinction between short-term and long-term deficits loses most of its relevance. Bo Structural adjustment in the developing countries would require a substantial investment effort, which would be difficult to finance out of domestic savings under conditions of low growth. External financing and open trade possibilities are crucial to this process, and so structural adjustment must be approached with reference to total external financial flows to these countries.

The first amendment to the IMF Articles of Agreement filled a major lacuna in the Bretton Woods system by creating an international reserve asset, the SDR. However, after an initial distribution of SDR 12 billion, the second distribution of 12 billion took place only in 1979-81. In all. SDRS presently constitute less than 4 per cent of official reserves. The international reserve system is still based on major national currencies, principally the U.S. dollar, and the volume of international liquidity is dependent on the course of its supply. Many improvements have been effected in the last few years , regarding the characteristics and use of SDRS, especially their interest' rate, but they are a long way from being the principal reserve asset of the monetary system-the objective set for them in Article VIII

[4]Ernest Stern, World Bank Financing of Structural Adjustment, paper, presented to the conference on IMF conditionality, March 2426, 1982, p. 13.

[ogee John Williamson, The Lending Politeness of the IMF, Institute I International Economics (Washington PC., August 1982), pp. 11-21.

The effectiveness of international monetary policy and international adjustment policy depends on the control of the monetary management over the volume and disposition of international liquidity. On this score, the Breton Woods system, based on a pool of reserves derived from members' quotas and not on autonomous reserve creation as initially suggested by Keynes, has always been limited in its resource base. In the face of the unprecedented payments disequilibria of the 1970s, the quota-based system had three direct consequences: (I) The resources of the monetary system proper were limited and bore no relationship to the evolution of economic conditions. Their expansion, moreover, was subject to political decisions of the major countries and national budgetary situations. (2) The conditionality attached to quota-based resources was fashioned in part by the limitation of funds and the necessity to preserve their revolving character. (3) In view of the great expansion of international liquidity outside of the official monetary system, the influence of the IMF was marginalized, as is shown by the inability of the Fund to supervise an international adjustment process essentially financed by private funds. Thus, a staggering amount of real adjustment, necessitated by the build-up of financial obligations of deficit countries, was postponed until the early 1980s.

These points are supported by a variety of evidence. In 1950, the quotas of the IMF were 12 per cent of total imports excluding the socialist countries. By 1970, the ratio was 9 per cent, and in 1976 and 1980 the respective percentages were 3.6 and 4.0. Of the total cumulative current-account deficit of non-oil developing countries over 1974-8I ($427 billion), the IMF financed only 3.2 per cent. Of total gross capital flows over the same period, the IMF share was 4 per cent, a share too small to affect the global adjustment.

The expansion of international liquidity in the 1970s was driven by the evolution of the balance-of-payments deficits of the major countries, in particular the O.S. The volume of foreign claims on the dollar increased from $50 billion in 1970 to $360 billion by the end of :1981. Opinions differ as to the contribution of this enormous ex son anion of liquidity to international inflation, but there is little dispute that the augmentation of liquidity accommodated inflation impulses which had domestic origins.

The expansion of transnational banks as a source of international nice in the 1970s was quite striking. In addition to providing port credits and short-term lending, private banks became a large
source of balance-of-payments financing. Private financial markets, principally transnational banks, accounted for 59 per cent of total gross financial flows to developing countries in 1981 as compared to only 38 per cent in 1972. This new lending insulated the world economy from a drastic deflationary adjustment in 1974-75 and no doubt lessened the impact of the severe 1979-80 downturn.

However, this private financing, affected independently of official monetary modalities, soon gave rise to many problems. As pointed out above, it diminished the influence of the international monetary system on the emerging pattern of global adjustment. It also distributed the available liquidity in accordance with its own private criteria of creditworthiness. This would not have been a problem if the international monetary system had the means to finance what it deemed appropriate, in a "residual central banking role": filling the gaps left by private markets and laying a safety net in case of - trouble.

Another problem which private financing rose was that of skewed distribution of finance. Ten countries have received two thirds of all bank lending to developing countries, and because of the amounts involved and the high costs of this financing, the recipient countries soon developed major problems. By 1982 the high and uncertain exposure of private banks to concentrated country risks, the increased cost of debt emanating from interest-rate increases over the previous two years, and the collapse of real export earnings of the major debtors combined to bring the financial system to severe crisis. As the banks began to cut back on new lending, key governments intervened to stop this process, to lay a safety net so that banks could

coordinate their new lending, and to provide public, funds to stabilize the financial system. This was an exercise of a kind, of 'residual central banking role."

The analysis of this interconnected system crisis throws into shad relief the relationships between the various forms of finance and t monetary system and clarifies the need for a mix of functional for of finance. The situation of the developing countries requires multiplicity of financing forms and mechanisms for cooperation, I bring about a proper financing mix, one which blends official a private sources with due regard to their associated cost and tutu stability and with reference to the evolution of the global adjust me process.

c) Macroeconomic policies and the system crisis

The macroeconomic management of the major countries played a crucial role in shaping the economic conditions which brought the system to its crisis. After the boom of 1972-73, the Dames came under pressures from both the demand and the cost sides. Inflation was already under way in most Dames as far back as the early 1970s, and it was endemic to many of the developing countries. The rise of oil prices in 1973-74 added to the inflationary momentum and, through its sharp impact on terms of trade also caused large payments disequilibria.

The cyclical downturn of 1974-75 brought forth a macroeconomic policy response in key countries which, on the whole, contained the deflationary spiral of adjustment but allowed only weak revival in economic activities. Outside of the United States, the upturn was rather feeble. But the inflationary momentum continued its pace, and cautious demand management made no headway in containing its underlying cost pressures. Oligopolistic price setting together with large wage increases, in a setting of commitment to full employment,
is succeeded in imbedding inflation into the social and economic fabric.

f The international adjustment process worked in a rather undesirable way. The Dames succeeded by 1978 in balancing their payments, principally through favorable changes in terms of trade rather than real reduction of consumption, exporting their inflation in the process. The adjustment of deficit developing countries showed two distinct patterns. The major debtors, mostly the NICs,
• borrowed heavily and expanded their exports, while the rest generally made a deflationary growth adjustment. In all of this, the system itself had no independent policies; it more or less sanctioned the policies actually pursued by the key members. By 1979-80, most Dames concluded that priority must be given to fighting inflation, and policies shifted decidedly to a deflationary stance. The main instrument employed was monetary policy, acting on overall demand
t levels. Import demand was especially hard hit by the demand 'compression, and international trade leveled off and declined in 1982.

The second rise of oil prices in 1979-80 unfolded in the midst of <this deflationary course. And as the 1980 contraction spread, the :,international economy was caught in the dynamics of a global ession. The macroeconomic policies in this recession allowed the II brunt of contraction to be reflected in the developed market
economies. The international system reinforced these policies and in some cases, as in the reaction of banks to the grave difficulties of debtors, magnified the deffationary forces at work. Thus the reactions of the official international system were conformative rather than corrective.

## IV. PRELIMINARY SUGGESTIONS FOR REFORM

In the light of the discussion so far, it would seem that the major areas in which system reform is most needed are the international reserve system, the relationship of monetary management to financial flows, the adjustment process, and the residual central banking role, as defined earlier. Beyond these specific system reforms

lies the - larger task of creating mechanisms for overall steering of the system, forged in the framework of interdependence. There are two main tasks involved here: first, that of institutionalizing a restricted form of international economic management in money, trade and finance, and second, that of coordinating the national macroeconomic policies of the key countries. Such an approach would be far more promising politically than attempting to construct a whole new system.

It should be said at the outset that for the most part the terms of reference of the existing system remain valid, with the one exception of the position of development in the overall objectives of the system. The effort for development of the Third World is not to be justified solely on moral and political-strategic grounds, but also on those of the viable operation of the world economy. The developing countries have emerged as important partners to the developed countries in trade, finance, global resources and economic management, and a new "development consensus" must be forged on this basis. Such a consensus is needed not only for the long-run growth of the world economy, but equally for its short-term management. Put differently, the new "development consensus" must include a consideration of development in the main workings of international economicmanagement-not in resource transfers or special arrangements alone.

Elements of International Economic Management within the Frame work of interdependence The demonstrated compartmentalization of the existing insti - tutions should give way to an approach which recognizes th. interdependence of sectors. This would involve changes in the conception and operations of the various subsystems, as suggested below, as well as setting up institutional modalities for overall decision-making. I will begin by identifying policy elements at the international level which may form the basis of limited international economic management. One such element would be a positive policy of structural adjustment, which would steer the advanced economies towards more knowledge-and capital-intensive industries and gradually away from traditional ones. International coordination could facilitate this transition, helping to avoid the mistakes of anticipatory unilateral industrial policies and to discourage defensive and protec tionist policies in traditional industries.

Another element would be a policy of resource utilization and full employment. While these responsibilities lie in the national domain, international coordination would be very desirable. The promotion of development and structural change in developing countries would aim at efficient utilization of resources and at diversifying the productive basis of these economies. Toward this end, both the development of indigenous sectors and the reallocation of resources from advanced countries would be promoted. Modalities of industrial collaboration, joint ventures, co financing, and equity-participation could be devised. In the same vein, the international system should set rules and priorities for the investments and activities of TNCs, marrying the interests of the owners of capital with the sovereign rights and economic concerns of the host countries.

Another area of international management would be the establishment of a much greater degree of security in access to markets. Such a system would derive its force from a greater rule of law as well as from the application of economic policies in support of trade liberalization, notably measures to promote structural adjustment.

Securing broad consistency among national macroeconomic policies of the key countries, including exchange and interest rate policies, should be at the heart of this international management. And yet another element might be to activate mechanisms against financial instabilities, assuring the availability of resources to system members through a combination of national aid policies, the systems
' residual central banking role and some degree of balance-of-payments financing. Specifics are given below.

The institutional innovations these reforms entail should not be ': difficult to devise. One possibility-perhaps overly ambitious—is to
create an international economic council, similar to the U.N. Security Council.

Another is to revive the dormant "Executive Council" that was to be established in the IMF and endow it with overall system powers. A third possibility would be to create a body, invested with these economic management powers, which would report to the U.N. General Assembly and the governing boards of the various institutions. Whatever the institutional modality chosen, the body in question should meet periodically for policy decisions and should be in regular and frequent session for ongoing operational decisions. Specific Suggestions in Money and Finance

a) The international reserve system

The international reserve system of the future should give substance to the standing commitment to make the SDRS (or some other agreed international currency) the base of the system. The relevant functions of such a currency would be those of enumerative, a , reserve asset and an international vehicle currency. In the latter function, the international currency would have to exist side by side with key national currencies circulating in international markets, but it would be the currency of the international system and its vehicle of operation. Eventually, therefore, private holdings or at least commercial bank transactions in the currency would have to be permitted, according to international agreement and to the evolving importance of the currency. The ability of the system to control the creation and distribution of its international currency would underpin its funding operations in the context of its adjustment policies and global macroeconomic aims, and would give it needed flexibility.

There should be a reconsideration of the maximum limits to SDRS in the designation procedures of the IMP. Unlimited acceptability of SDRS in the context of an active secondary market, provided initially by the central monetary institution and eventually by the private markets, is indispensable for transforming the SDR into a widely accepted money in the eyes of holders. To this end, its issue should be 6' regulated by a strict international agreement. To enhance the share of SDRS in international liquidity, facilities for a substitution mechanism

from foreign exchange holdings into SDRS should be provided. This " - does not necessarily mean substitution on a massive scale for the entire stock of foreign exchange holdings currently considered as international reserves, but rather a mechanism to provide a safety-valve for varying the stock of non-SDR holdings when desired.

The distribution of SDRs in a reformed system might run through three channels. One portion might be related to the weights assigned to various countries in the constituency, analogous to the present quota reference, thus giving members a share commensurate with their stake in the created reserves. The second portion would be given to the operational account of the central monetary institution, to augment its resources and be used in its balance-of-payments and general support financing. This then would constitute an autonomous source of growth to underpin the system's economic management. Clearly, such an arrangement entails attaching conditionality to the use of a portion of SDRs, to avoid the danger of inflationary tendencies. The third portion of SDRs would be used to release resources for certain agreed international undertakings such as the financing of some operations of development institutions (e.g., the IBRD) or the development of certain global resources under international auspices.

The arguments advanced in the past against the no monetary use of SDRs seem on balance unconvincing and have been decisively answered by Robert Tiffin, Fritz Mach up and John Williamson." One of the chief of these arguments relates to the inflationary potential of the SDR, which, however, cannot be assessed independently of the inflationary contribution of the free issuance of key currencies constituting the bulk of international liquidity. The argument that SDRs may add to an excess supply of international liquidity takes for granted the supply of the important other components of international liquidity and assigns the blame to the marginal contribution of the one additional currency)'

b) The adjustment process

The issues of adjustment have been discussed in 111 above. Essentially, the reformed system should have a conception of adjustment that has a wider purview than the trade account. And it should abandon its short-term approach and recognize that long-and

II Robert Tiffin, the Indispensable Reordering of the World Monetary System," in Global Development: Issues and Choices (North South Roundtable, 1983), pp. 103-108; Fritz Mach up, "The Cloakroom Role of International Reserves: Reserve Creation and Resource Transfer," Q.J. C...

August 1965; and John Williamson, The Failure of World Monetary Reform (New York University Press, 1977), ch. 6. ~[1]See Williamson, Failure of World Monetary Reform, ch. 6.

short-term problems cannot be neatly separated. Moreover, me deficits of many countries in the past few years do not stem mainly from domestic sources. In correcting persistent deficits, distinctions should he drawn between cases like that of Turkey in 1980, where export adjustment was possible, and cases like that of Brazil in 198283, where export adjustment was not possible and further demand compression was harmful.

It is crucial for the health of the world economy that adjustment be approached on a global scale. This means that the central monetary institution ought to have a broad conception of an acceptable and appropriate pattern of deficits and surpluses to the world economy, and it should have the resources and mandate to act on this conception. Focusing on the deficit country alone has led to three problems: (a) it has created an aggregation problem, in the deflationary recommendations of the Fund in the midst of the recent global recession; (b) it has thrown the burden of adjustment on the countries

in need of official funds; and © it has ignored the dynamic conse quences of short-term deflation on growth and resource employment. In the reformed system, there should be a time dimension to deficit correction, not prefixed, but determined in the context of global economic considerations. The mix between financing and real adjustment would be determined on the same basis. And alternatives to financial programing based on a price mechanism should be developed for deficit correction particularly in countries with rudi mentary market processes. e) Residual central banking and global economic management In today's world, the economic management role envisaged for a reformed system must be a limited one. However, policy coordination 3r; in the context of a system of rules, sanctions and incentives can bring j. pressure on national policies and impart direction to them, helping to avoid anticipatory mistakes and opening up possibilities of action hardly feasible in a unilateral context.

In regard to international financial policies, I have advocated a limited form of international central banking, or "residual central.L banking.' with the responsibility to consider the entire matrix oF, international financial flows and, when appropriate, to play $ balancing role in the system. One need in this respect is a finanei>i safety net for international lenders. While, in principle, nation=; central banks have the ultimate responsibility to protect and cost their own banks, the internationalization of banks' operations necessitates an international approach for dealing with problems that arise, to assure the safety of international savings and to prevent massive destabilizing movements in banks' behavior. Such an approach is also necessary to control monetary shifts among currencies. The rescue operations led by the U.S. early this year are a good ~f example of this role.

**d) The exchange rate system**

The old Bretton Woods system of fixed but periodically adjustable exchange rates is better than a floating system, under the right conditions. But with differences in economic policies and differences in inflation rates, the fixed-rate formula is not viable one. Additionally, it is an open invitation for speculators and puts a straightjacket on economic management. This does not mean that the managed floating system in effect since March 1973 has brought with it all the

benefits claimed by its advocates. It has made only a modest contribution as an adjustment regime, has increased reserve use, and has been volatile. A reformed system with effective economic management would likely be the best approach to achieving the economic policy coordination needed to stabilize the exchange rate trends.

A mixed system, with open market operations in SDRs in the context of economic management, should go a long way towards eliminating disorderly conditions in the exchange markets and wide unwarranted fluctuations. And when circumstances permit, target zones of exchange rates with periodic adjustments might be envisaged. The experience of the European monetary union is valuable in this regard.

**e) International financial issues**

From the standpoint of international financial cooperation, the ability of the financial system to mobilize global excess savings and offer the financial services needed in an interdependent world is dependent upon the existence of a safe framework based on the respect of contracts of individual participants. Hence, an important undertaking in the reform process is the elaboration of an

..international charter of rights and obligations, to bring international capital placements of all forms under an agreed system of international law. The scope of such a code or charter would provide a quid pro quo among borrowers and lenders, investors nd savers.

The need for external finance in the future will increase for all countries and a higher degree of financial integration will go with it. A multiplicity of financial forms and modalities will be needed to meet the needs of savers and investors. Hence a major task of reform is to devise such modalities.

For the developing countries, the question of "finance mix," blending various forms of finance from private and official sources so as to afford them terms and conditions suitable to their situation, will have to be given due attention. For the poorer countries, official aid flows will continue to be indispensable, and such aid should be made more stable and predictable. For this, a great deal of public education and a higher political purpose are needed. Official financial cooperation should posit the financing of deliberate development as one of its aims and "common goods."

f) Tire instirurfons

The prevailing institutions have been criticized here on four grounds: they have reflected the views of the dominant developed countries and their market-based orientation; they have had a marginal funding role; their funds have had tough and sometimes unsuitable conditionality; and they have afforded only limited participation in decision-making to the developing countries. The existing institutions were neither created to exercise an independent international role nor endowed with enough resources to meet the demands subsequently placed upon them.

If the global economic management function proposed here were effected, there would be substantial changes in the conditionality of the central institution and the size of its resources. Nonetheless, the international system will always have limited resources, especially in relation to needs. Thus it must have flexibility and, under intergovernmental control, significant autonomy.

As to the question of political dominance, a reformed system can at best be democratically representative but cannot, for the foreseeable future, be managed on the basis of equality. It is unavoidable that big members will dominate decision-making. However, there is room for marginal modifications in the overall balance of power.

All such questions are properly the subject of intergovernmental negotiations. The only safeguards will be to invest the international system with a sufficient degree of autonomy and to hold it to Ihth highest standards of international civil service.

# APPENDICES
## Appendix A
## Statement from Istanbul

I. The world economy is in serious trouble. It cannot function smoothly again without careful management and some fundamental changes. The dilemmas we face are complex and many:

• Sustained growth of the world economy is the only viable, long-term solution for most of the current problems. Yet such sustained growth is simply impossible in the prevailing environment of trade restrictions, shrinking world liquidity, and deflation in many countries.

• The creation and distribution of world liquidity have become increasingly uncertain, because of both the ad hoe policies governing national reserve creation and increased dependence on private financial markets.

• The distribution of world economic and financial resources has become increasingly multicolor, with the U.5. Share of world GNP declining from two-fifths to only one-quarter in just over two decades, while the carol of world financial policies has remained largely monolithic, owing to the predominant role of the U.S. dollar.

• There has been a gradual retreat from multilateralism precisely at a time when the world has been growing ever more interdependent, requiring cooperative solutions, not isolated national actions.

The human and social costs of short-term adjustment measures have become severe, with the poorer segments of societies shouldering disproportionate burdens.

2. Sustained growth in the world economy is vital to all countries for the creation of jobs, for reduction of debt burdens, for a lessening of protectionist pressures, and for new investment that will permit smoother adjustment. For the developing countries in particular, benefits from sustained world growth should include higher commodity prices and increased exports-which should improve their development prospects and reduce debt burdens. Recovery can be strengthened and broadened by appropriate expansionary policies in industrialized nations, by positive adjustments in their industrial structures, by reducing barriers to the developing countries' exports,

L and by providing them with increased financial flows in order to overcome debt-caused constraints on their growth. Reduced interest rates, especially in the U.S., are necessary both to support recovery developing countries. These institutions have made extremely valu

able contributions to development in the past but are now con

strained by limited resources. Their capital should be increased substantially, restrictive policies and conservative gearing ratios should be prudently eased, and their policies should emphasize rapid disbursements of already approved loans. There should be an immediate expansion in the IRRD's capital through a selective increase that would parallel the eighth review of IMF quotas. In the field of human resource development, the United Nations Development Programme plays an important and unique role. At present this organization too is facing critical resource constraints. There is an urgent need to provide the UNDP with the necessary resources on a

more predictable and assured basis.

8. Greater financial flows would permit countries to adopt a less concretionary approach to adjustment which could both meet medium-term balance-of-payments objectives and minimize costs in

terms of human suffering. In low-income countries especially, con vent ional

adjustment through deflation creates considerable hardship and is generally ineffective in increasing exports because of the
inelastic demand for the commodities of these countries.

9. The debt situation in developing countries was largely caused by
the very rapid accumulation of debt during the 1970s, increasingly incurred at variable interest rates, which with high interest rates has led to a very heavy debt-servicing burden. Debt rescheduling to date
have been ad hoc and have generally increased the medium-term cost of debt, raising repayments, and often resulting in further reached rulings. There is need, therefore, for some orderly and systematic
process of restructuring debt, when needed, so as to ease the stifling constraints on development efforts. A range of proposals to this end has been made, some involving the creation of new institutions, some the use of SDR5, some the application to the international situation of practices already standard in domestic banking. It is imperative that all of these proposals be seriously investigated and some solutions be found that reduce the burden of past debts and distribute the costs of so doing among borrowers, lending institutions, and developed countries, all of which bear some responsibility for the current situation. Special provisions should be made to deal with the particular problems of the poorest countries, many of which suffer from serious debt crises.

10. For the poorer countries, additional concessional resources are r essential. These could come from extra aid and from distributing a higher proportion of existing aid flows to these countries. In this connection, it is necessary for the development community to give a very high priority to the question of IDA replenishment_ IDA is now the largest single source of concessional finance to low-income countries. The present problems with replenishing IDA are essentially related to lack of adequate support from its principal donor. Accordingly, it may become necessary to supplement IDA funds during its seventh replenishment period with a special account to be financeable by donors other than the U.S. The fact that two countries, the U.S. and U.K., are reducing aid flows has not prevented the rest of the industrialized world from increasing its aid. It is imperative that the level of aid increase and that pressures be put on those who are lagging behind. Industrialized socialist countries should also make a proportionate contribution to concessional flows.

I I. The evident deficiencies in the current international financial system do not necessarily flow from institutional inadequacy, but come rather from the underlying political realities. The IMF has played a crucial role in difficult circumstances in preventing the breakdown of the international financial system. The world recession is not due to international institutions, but rather to the economic policies of the major countries. Nevertheless, since the institutions are important in defining minimum codes of behavior for member countries, in permitting a fuller exchange of information, and in generating pressures for change, institutional reform may make a significant contribution to the process of adjustment and development. There is a need for an enlarged role of the IMF in providing shorthand medium-term finance. There is also a need for a considerable expansion of the World Rank and other multilateral financial institutions. However, deficiencies remain in the performance of various institutions: notably in functions such as lender of last resort; smoothing interest rate and exchange rate variations; liquidity creation and distribution; monitoring international bank practices; and facilitating debt rescheduling. Reform of existing institutions is one possible way to secure improved performance in these functions. Another long-term possibility is the creation of a world central bank; but it is yet to be determined whether this would be technically and politically feasible. All of these proposals should be investigated in depth.

12. One of the underlying, though not visible, obstacles to economic progress is the insufficient attention given to the development of human resources. The “capacity and management gap” has not been bridged by official development assistance (ODA), which has been predominantly used for physical capital formation.

Solutions which do not take the human dimension and human resource building into account will fail to provide an enduring answer to the world's financial and monetary crisis. Until human resources needed for sustained economic growth are developed, real development will remain a dream.
13. In our fervent search for economic recovery, for monetary and financial restructuring and for appropriate institutional responses, let us not forget that people must be at the center of all our concerns. In the last analysis, we must judge all adjustment processes, all policy options, all institutional alternatives by the same yardstick: the impact they have on human welfare. This has been the basis of our deliberations in Istanbul and will continue to guide us in our future search for a viable international system.

# APPENDIX B
## Bretton Woods IL An Agenda
**Dragoslav Avramovic**

Four subjects are suggested as the core agenda of the world financial and monetary conference:
(a) debt reorganization;
(b) reconstruction of the international monetary system; (c) reform of development finance; and (d) organization of international financial institutions.

## DEBT REORGANIZATION

At the end of 1982, short-term debts of developing countries, i.e., debts with a maturity under one year, were estimated at US $160 billion, compared to $60 billion in 1978. Prior to 1981, such debts were almost automatically rolled over. In the debt crisis of 1981-82 this practice stopped, and a number of developing countries confronted a sudden need to repay massive sums out of dwindling or nonexistent exchange reserves. Many were compelled to request postponement of payments. and the accumulated short-term liabilities now hang as a sword over their heads and, in a sense, over the heads of their creditors as well. No solid financial structure in the future can be envisaged without a conversion of a large part of the short-term debt into long-term. The other side of debt reorganization concerns the rate of interest.
At least US $700 billion of debt of developing countries is contracted at floating interest rates. These rates, consisting of the base rate (LABOR or U.S, prime) and the margin to reflect country risk, are now running at 12 per cent on the average. As the export prices of , developing countries have long since stopped increasing, the nominal 12 per cent rate equals the real rate for them. At this rate, the debt burden will rise with almost mathematical certainty. Debtors will be compelled to borrow at 12 per cent interest just to pay interest; debt will virtually automatically increase faster than real output; and a rising proportion of national income will be absorbed by debt service abroad, until either debt principal is scaled back, or the rate of interest is reduced. In the case of bank loans, renegotiation of, interest rates will involve the somewhat complex matter of uragostav AvramovicJpage 30 5renegotiating the rates of interest with the depositors.
For the next year or so a great many individual debt negotiations will be going on.

Judging by recent experience, they will result mostly in temporary arrangements. It is in the interest of debtors as a group that an organized multilateral settlement eventually be negotiated. A number of proposals made by prominent financiers and economists in the Western world demonstrate that it is felt in the creditor countries as well that such an organized settlement would be in the collective interest of all parties. Consultative negotiations would have to start quite early and would, it is hoped, be finalized in a formal multilateral agreement with appropriate institutional arrange ments at Bretton Woods

## II. RECONSTRUCTION OF THE INTERNATIONAL MONETARY SYSTEM

Three major concerns are involved here: first, the size and allocation of future issues of Special Drawing Rights (SDRs), improvement in their marketability and their future role as an international reserve asset; secondly, future organization of balance-of-payments support to meet disturbances of the size and severity experienced in recent years; and thirdly, modalities of international monetary co-operation aimed at reduction and stabilization of interest rates, stabilization of exchange rates and reduction in international speculative capital movements.

The future of SDRs is becoming a central issue for several reasons: because the U.S. financial authorities are showing an increasing unwillingness to supply dollars to the outside world to meet its liquidity and reserve needs in view of the U.S. domestic budgetary problem and the pressure on its balance of payments; because the authorities of other reserve currency countries, or potential reserve currency countries—the Federal Republic of Germany, Japan, Switzerland, the United Kingdom and Saudi Arabia-are unwilling to play individually or even collectively the role which the U.S. Treasury played for decades, that is, being a de facto lender of last resort; because the confidence of Western governments that the private international banking system will continue to supply liquidity

f and reserves on a wide geographical basis has been severely shaken, after the collapse of bank lending to the newly industrializing countries in August 1982; and because, rightly, nobody in power is prepared to take the risk of attempting o restore t world old s and But Issues of SDRs seem the only way out, the questions remain: how much? to whom? and how to make them become an international currency instead of the hybrid of credit and money that they are now?

Experience since 1973, and particularly since August 1982, has in a shown that the present system of balance-of-paym S t5 support t little one crisis, centered around the IME as now organized,

and too late. The IMF was established to act momentarily in periods of balance-of-payments stress in order to prevent and welfare, having devastating effects on trade, because the experience of the 1930s had shown that ad hoc deals hurry. We^t are nowsback rtotad hocpdeals,eand'perhaps m a^kworse way-involving a large number of private banks, each central banks, it own BIS, the IMF, export credit agencies, and so on, objective and pulling in its own direction. In the meantime, crisis and deflation spread. An overhaul is indicated. The issue of international monetary ycoop Without erati n iis probably most difficult, conceptually and stabilization is probably impossible; and without the latter, com petitive depreciation and trade conflicts will increase sharply. In 19$ I, the estimated exports of funds through the exchanges from the Us. alone were some US $100 billion. At the end of 1982, the foreign assets of Swiss banks were estimated at 350 billion Swiss francs, or about US $175 billion. These assets in part represent holdings of nationals and companies of the U.S. and Swiss European Arab, and Latin American countries, portion of these funds intermediation

is in and protection. A large constant movement across exchanges, in response to interest rate and exchange rate changes and other factors. While the BIS seems optimistic that central bank intervention in exchange markets could be helpful, it must be asked whether any central bank has enough resources to cope with the flows of private liquid funds of the magnitudes now being encountered. The remedies are either controls over capital movements or reduction of international differences in - interest rates. The developing countries have little choice but controls, particularly after the experience of Mexico and some others in
recent years. The developed countries, whose unawi11 rmarkets ha reached an unprecedented degree of integration,

The only choice left is coordination of monetary policies in order to reduce international differences in interest rates. However, as interest rates are a result of much deeper forces than monetary policy, except in the very short run, and as there is an enormous political pressure almost everywhere to reduce the world level of interest rates (in addition to reducing their fluctuations and their intercountry differences), what we are really talking about is international coordina
tion of fiscal, expenditure and broad economic policies, probably to a degree never tried before.

**REFORM OF DEVELOPMENT FINANCE**

**In 1979 the Brands Commission Secretariat identified six gaps in**

the financing structure, mostly in the area of development finance: (a) long-term program lending; (b) lending for energy and minerals;
© export credit
(d) Assistance for cooperation among developing countries, such
As support of payments arrangements, regional and sub region_ al reserve schemes, and ECDC joint ventures;
(e) Commodity stabilization finance; and

(0 finance for debt reorganization.
Progress has been made in program lending and energy finance, but it is small in relation to the needs, remained. The Common Fund for commodities is gaps in the process of signature and ratification.
Work is currently under way on the feasibility of a Bank for Developing Countries (South Bank), handled by the Group of 77. If established, the Bank may take upon itself the task of filling some of the gaps, particularly as they affect ECDC finance, export credit, and perhaps commodity stabilization. Much will depend on the amount of resources the Bank would be able to mobilize. It is safe to assume, however, that substantial unfilled needs will remain for consideration at Bretton Woods II, i.e., in a worldwide rather than South-South context, particularly in program lending, energy fi-nance, and debt reorganization.

The removal of restrictive clauses and precedents which have dominated the past policies of multilateral development finance institutions would also require consideration at Bretton Woods II. Some examples of such restrictions are the inability to finance local currency expenditures to the degree needed; difficulties or inability of issuing guarantees; and arbitrary ceilings on certain classes of assets, such as program loans.

Many students of development finance have noted the institutional gap in the Bretton Woods structure, the gap between the long-term project loans of the World Bank (and subsequently the regional banks) and the short-term balance-of-payments lending of the IMF. The architects of Bretton Woods had almost forgotten, or did not fully believe in, long-term balance-of-payments (program) lending. The Bank Charter provides for nonproject lending only as an exception, and this has been a problem ever since. Bretton Woods II would provide the opportunity to close this gap. The needs for longterm program loans and the conditions on which to meet them will be central issues in the reform of development finance.

## ORGANIZATION OF INTERNATIONAL FINANCIAL INSTITUTIONS

As international financial institutions face a variety of development problems of increasing complexity, and as their staffs include rising numbers of developing-country nationals, changes have come about in their operations, attitudes and image. Control has remained firmly in the hands of major developed countries, however, and this has been decisive for the scope of operations and lending policies. Furthermore, the institutions have retained virtually without change the theory of economic policy and the "mind-set" which have been their hallmark since the beginning, setting them apart from the views held by many developing-country members and bringing them into frequent country conflicts, particularly concerning conditionality.
Since 1950, the persistence of this adversary relationship and the existence of unfilled gaps in the financing structure have led to numerous proposals for the creation of a new worldwide financial institution or new facilities in the existing institutions, or both. The last of these was a call by the Brandt Commission for consideration by the international community of a World Development Fund, specifically designed to fill the gaps left by the Fund and the Bank and to do so on the basis of partnership between lenders and borrowers-which would be a novel feature in international economic relations.

This entire set of issues-conditionality, reform of existing institutions, management structure, modification of control commands, creation of a new institution or facilities, in short, the possible ways in which the “mind-set” can be transformed into a many-minded approach and replaced by participatory management while retaining the capacity to act and mobilize funds-will inevitably be at the center of political considerations at Bretton Woods II. If these issues can be settled satisfactorily, much of the North-South dispute will have been resolved.

Another organizational issue of major importance is the place and role of socialist countries of Eastern Europe (and elsewhere) in the system of international financial institutions. Daniel Yergin has shown that the formal beginning of the Cold War in 1946 coincided with George Keenan’s appeal not to make a special effort to persuade the U.S.S.R. to ratify the Bretton Woods Agreement (Yergin, Shattered Pewee). Another opportunity for all parties would arise at Bretton Woods II; and if the universality of financial institutions can be agreed upon, it might in many ways contribute to the end of the Cold War and thus to reduction of spending on armaments. This would be the ultimate success of Bretton Woods II.

## PREPARATIONS

Forces now at work are likely to lead to a decision to hold the world financial and

monetary conference in 1984: the call by the Non-Aligned Summit in March 1983, the view of the U.S. Secretary of the Treasury of December 1982, the likely call by the socialdemocratic governments of Europe (Austria, Finland, France, Greece, Spain and Sweden) in their forthcoming program of world economic recovery expected in May 1983. The perspectives of these various powers are different, however, and so are the objectives. There is no chance of the success of Bretton Woods II without a broad, precise, methodical and virtually full-time technical preparation on the part of each of the major country groups and then of all groups together. The history of preparatory work for the original Bretton Woods, described by Sir Roy Harrod (The Life of Keynes), shows the magnitude of the job even when only a few dominant powers and even fewer dominant personalities were involved. The present situation and relations of forces are much more complex, calling for even greater sustained efforts.

## APPENDIX C
## Stabilization and the World Bank: A Footnote to Drag Slav Aramaic's Agenda for Bretton Woods II

**Sidney Dell**

The following discussion is addressed /a point made in the last paragraph in the third section of Drag Slav Aramaic's paper, in which he draws attention to 'the institutional gap in the Bretton Woods structure." This institutional gap, which is by now admittedly a real one, did not exist in the original Articles of Agreement of the two institutions, as is made clear in this discussion. Consequently, one of the available options for dealing with the "institutional gap' is to restore the original concepts of Bretton Woods concerning long-term balance-of-payments financing.

It is commonly assumed that the World Bank is not entitled under its Articles of Agreement to engage in lending operations that would have, as their main purpose, the support or strengthening of balance of-payments positions of member countries. Although the World Bank's program lending is fundamentally indistinguishable from balance-of-payments support, it has generally been considered necessary to provide a rationalization for such lending that would avoid the charge that the Bank is encroaching upon the responsibilities of the Fund. Thus the objective of program lending is often represented as being to prevent the disruption of development programs in countries faced with the need for correction of short-term balance-of payments problems, and the Bank can thereby be said to be supporting development, not the adjustment of the balance of payments.

In early 1980, the Bank's program of lending in support of structural adjustment was introduced as a response to pressure by developing countries for recognition by the Bretton Woods institutions that their current balance-of-payments problems were predominantly of a structural character, resulting as they did from a basic shift in the terms of trade. The Bank's justification for the new program came close to asserting a general case for long-term lending in support of the balance of payments. The Bank pointed to the need for supplementing the relatively short-term finance available from the commercial banks and the resources available from the IMF, both in amount and maturity, if the debt problems of many countries were not to assume serious dimensions, or, in the case of countries without access to private capital markets, if growth rates were not to fall to unacceptably low levels. It is unclear how far this line of reasoning has been accepted by the countries supplying most of the financial resources required by the World Bank and IDA, but whatever positive reactions there may

have been have certainly not sufficed to generate additional resources for the World Bank Group on the scale required. Moreover, considerable concern has been

Expressed as to possible confusion of Bank and Fund functions.

Although the concentration of the World Bank on project lending during the past thirty-five years, as against the Fund's general balance-of-payments financing, has created a pragmatic basis for the view that the mandates of the two institutions are quite distinct, examination of the record shows that the World Bank has clear authority to make long-term loans for stabilization purposes. In fact the idea of endowing the Bank with monetary support functions is as old as the concept of the Bank itself. The first draft, dated April 1942, of the so-called White Plan-the United States plan for a Fund and Bank-contained the following passage, referring to the Bank:

Loans made for the purpose of providing metallic reserves or otherwise

Strengthening monetary systems of the borrowing country should bear

lower rates of interest and longer terms of repayment than loans made for other purposess I When, in the same year, the United States government received from the United Kingdom a copy of the alternative Keynes plan entitled "proposals for an International Clearing Union," the very first set of questions addressed jointly by the U.S. Department of State and the U.S. Treasury to the British in order to obtain clarification of their proposals included the following:

If any international agency is to have the authority of issuing an international currency, would it not be more appropriate to reserve such authority for an International Bank?

The reason given for easier terms for such loans was that they would not yield "easily measurable' profits. It was also argued that the risks incurred in lending "metallic reserves" would be less than for other types of loans.

For these reasons it was felt that the interest rate on such loans could be "even as low as one percent."

These ideas about the functions of the Bank seem to have disappeared in later drafts of the Bank proposals, possibly because of a division of opinion within the U.S. Treasury as to their wisdom. Nor were they explicitly discussed at Bretton Woods.' However, the recommendation that the Bank should be responsible for long-term lending in support of stabilization programs was brought out into the open again in 1945, during the Congressional hearings on the Bretton Woods Agreements Act, under which the United States was to ratify the Articles of Agreement of the Fund and Bank.

For the U.K. government, the proposal put forward during the Congressional hearings that the Bank should have authority to make stabilization loans appeared obviously correct. In writing to Dr. Bernstein about this subject, Keynes disposed of the issue in two sentences:

The interpretation that the Bank is free to make stabilization loans is entirely unexceptionable from our point of view. It is just how we have always understood it! Subsequently, in the course of a longer comment for his official colleagues. Keynes wrote that:

There can he no doubt that the Bank both has, and was intended to have, the necessary authority [to make or guarantee loans for ... the reconstruction of monetary systems, including long-term stabilization loans]. We could without hesitation support the Americans, both in the matter of interpretation and also in voting for a change in the constitution, should it come to that?

Since Keynes had been Chairman of Commission II, dealing with the Bank, at Bretton Woods, his view of the intentions of the Conference in this matter must be regarded as authoritative.

Subsequently. Section 12 of the Bretton Woods Agreements Act, as ultimately adopted, and directed the U.S. Governor and Executive Director of the Bank:

See Keynes's comments to Bernstein, quoted below.
The Collected Writings of John Marnard Keynes, edited by Donald Moggridge for the Royal Economic Society (London: Macmillan, New York: Cambridge University Press, 1980), Volume XXVI, pp. 1945. Keynes was here commenting on what he regarded as one of the four main issues that had been raised during the Congressional hearings on the Bretton Woods Agreements Act. Ibid., p. 198.
to obtain promptly an official interpretation by the Bank as to in authority to make or guarantee loans for programs of economic recon =traction and the reconstruction of monetary systems, including long term stabilization loans. If the Bank does not interpret its power tc include the making or guaranteeing of such loans, the governor of the Bank representing the United States is hereby directed to propose promptly and support an amendment to the Articles of Agreement for the purpose of explicitly authorizing the Bank, after consultation with the Fund, to make or guarantee such loans.
This provision resulted from acceptance by the U.S. Congress of a view widespread in the American banking community that "some stabilization programs will call for long-term loans." The reasoning underlying this view was set out in a report issued in 1944 by the Research Committee of the Committee for Economic Development .6 The Committee, which was headed by the prestigious Presidents of the Federal Reserve Banks of Boston and St. Louis, and which included Paul Hoffman, subsequently Administrator of the Marshall Plan, among its members, was of the view that the purposes of the Bank, as stated in the Bretton Woods Proposals, did not seem to be sufficiently broad to include loans expressly intended to serve the requirements of long-term stabilization. The Committee went onto say that:
There will probably be a need for long-term loans of a type for which there is no provision at present under either the Bank or the Monetary Fund. The Bank's loans, as at present provided, are to be for specific projects of reconstruction or development; but there will probably be a number of countries that will need some more general form of loan assistance than these specific projects imply-loans designed to provide for imports of a variety of goods and services in a general restoration of a country's powers of production and trade.... The managers of the Fund require and deserve the protection to the clarity of their operation that would come from clear authority to the Batik to make loans for stabilization purposes when they are justified. Otherwise, there will be pressure on the managers of the Fund to permit transactions not consistent with the short-term stabilization operations of a currency fund?
=Testimony of W. Randolph Burgess, President of the American Bankers' Association, before the United States House of Representatives Committee on Banking and Currency, 21 March 1945.
^The Bretton Woods Proposals, a statement on national policy by the Research Committee of the Committee for Economic Development, 1944.
'Ibid. Emphasis is that of the Committee.
Obviously the CED Committee had principally in mind the structural balance-of-payments difficulties of countries faced with reconstruction
problems. But the basic principle underlying their view was that in cases where pressures on the balance-of-payments could be overcome only through long-term structural adjustments, countries engaged in stabilization programs might need to borrow at long-term, and that the Bank should be given authority to provide for such needs.
In the event, the Executive Directors of the Bank, responding to the United States' request for an interpretation of the Bank's authority in this matter, decided on September 20, 1946 to approve the report (R-28) of its Committee on Interpretation, which concluded that:
Under the Articles of Agreement, the Bank has authority to make or guarantee loans for programs of economic reconstruction and the reconstruction of monetary systems, including long-term stabilization loans.

This authority has, however, remained unutilized. The Bank has never made a loan specifically for the purpose of stabilization along the lines contemplated in the decision of its Executive Board, although it has, as noted earlier, undertaken a modest amount of program lending to a few countries.
The de facto curtailment of Bank authority in regard to long-term stabilization programs would have been natural if it had been 1
Accompanied by a corresponding expansion of IMF functions. But this was not done either. On the contrary, IMF lending was for many years restricted to three- to five-year maturities, a limitation for which there was no authority in the original Articles of Agree- f mint. It is only recently that the Fund has moved, to a limited degree, towards somewhat longer maturities, though even so not to
The extent of World Bank lending.
It was under these conditions that a major gap opened up in the 4 operating functions of the multilateral financing institutions as be
Teen the long-term resources supplied by the Bank in the form of e
Project loans, and the no project financing supplied by the Fund,
Original Articles of Agreement of the Bank and Fund, as shown v
Above. It was introduced subsequently for reasons that have never been made clear.
As has been demonstrated elsewhere's the existence of such a gap between Bank and Fund responsibilities has created
Growing difficulties in recent years. The structural maladjustment Q
characteristic of these years has been sufficiently severe to warrant comparison with the early postwar period and is likely to prove
much more intractable.
Sidney Dell and Roger Lawrence, The Balance of Payments Ad/unmenl Prorecs in Developing Countries (Oxford: Pergamon, 1980), pp. 120-121, 133-135,137-138.

## Appendix D
## About the North South Roundtable

The North South Roundtable, established in 1978 under the auspices of the Society for International Development, is an independent intellectual forum in which academics, researchers and policy makers from around the world come together to discuss global development issues. The Roundtable brings together experts from every continent in many fields, all sharing a commitment to orderly progress in human affairs, for the advancement of a constructive dialogue between North and South, developed and developing, rich and poor nations, in search of a more just and stable world order.
The Roundtable serves as a sounding board for the expression of new ideas, as a monitor for the North-South negotiations under way in official bodies, as a private channel for the unencumbered exploration of possibilities for consensus, as a public educator on global development issues, and as an informal meeting ground on which key policy makers in public and private life appear in a personal capacity. In annual sessions involving the whole membership of over I50 and in smaller sessions convened for the discussion of specific development issues; the North South Roundtable seeks to identify and analyze the most significant issues and to develop policy proposals in the mutual interest of North and South. The ideas evolved in the Roundtable process are disseminated to the general public, national decision makers and other international organizations, through Roundtable publications and through direct briefings.
The North South Roundtable is founded on recognition of the ever increasing interdependence—economic, political, and social-of the diverse nations and

regions of the world and is guided by a vision of world justice and world community. The Roundtable places hope in the process of North-South dialogue, for the discovery of new national policies and international structures in the interest of both developed and developing countries.

## ONGOING PROGRAMS

**The North South Energy Roundtable**. The North South Energy Roundtable is an international task force for the preparation of policy studies on the future of energy and a forum for dialogue on energy issues. The Energy Roundtable works to put energy in its proper international developmental perspective and to ensure policy makers' access to accurate analysis and data. The Energy Dialogue Missions of the North South Energy Roundtable visit developing countries, developed nations and international bra, to gather and relay information on national, regional and international energy policies and needs and to establish a dialogue with high-level policy makers within and among nations.

The North South Food Roundtable. The focus of the North South Food Roundtable is worldwide food security for nations and people. In meetings of experts in the food area, in briefings and in publications, the North South Food Roundtable works to assess the global food situation, to develop concrete proposals for the acceleration of food production in developing countries and the establishment of international food reserves, and to address long-term issues such as food research and technology, the energy-food nexus, and the development of markets and market mechanisms.

The Global Round the Global Round is a program of study and discussion on the North-South negotiation process, carrying on the work of the Brandt report and other international development reports. The purposes of the Global Round are to identify areas of mutual interest between North and South, to consider proposals for the restructuring of the Bretton Woods institutions, and to work with other international organizations toward the worldwide elimination of absolute poverty by the end of the century.

Roundrable on Money & Finance. This most recent program of the North South Roundtable has established an informal process of dialogue among policy makers in the public and private sectors, to initiate appropriate policies for the resolution of the current crisis in international finance. The Roundtable on Money & Finance has organized a task force of financial and development experts to assess the crisis—especially the flaws of the present system in adjustment and liquidity creation and in the relationship between private and international financial institutions-and to consider and formulate ': proposals for the revitalization of the world financial and trading system.

## NORTH SOUTH ROUNDTABLE PUBLICATIONS

Beyond the Brand! Commission, edited by Khadija Haq, 1980, NSRT, 120 pp.
Energy and Development an Agenda for Dialogue, by Sa] ah AIShaikhly and Mahbub ul Haq, 1980, NSRT, 25 pp. Energy for Development: An International Challenge, by John
Foster, E(rain Friedmann, James W, Howe, Francisco R. Para and David Pollock, 1981, Praeger, 304 pp., paperback.
Energy and Development. Policy Issues and Options, by John Foster, Mahbub ul Haq and Francisco Para, 1981, NSRT, 100 pp.
A Global Agenda for the Eighties, edited by Khadija Haq, 1981, NSRT, 128 pp.
Castel Gandoiifo Report on Renewable Energy: Policies and Options, by Maurice Strong and Mahbub ul Haq, 1981, NSRT, 25 pp. Food Security for People and Nations, by Hossein Ghassemi,
Khadija Haq, Dale Hill and Martin McLaughlin, 1982, NSRT, 76 pp
Cancun: A Candid Evaluation, by Roundtable Members, 1982, NSRT, 88 pp.

Global Development Issues and Choices, edited by Khadija Hay, 1983, NSRT, 231 pp.

## APPENDIX E
## About the UNDP Development Study Programmed

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The Development Study Programme of the United Nations Development Programme (UNDP) was established by the Governing Council of UNDP in 1981, in order to:

(a) Promote a greater understanding of the issues concerning development and technical cooperation;

(b) Strengthen public and governmental support for development and technical cooperation;

© generate new ideas and innovative solutions to the problems of development and technical cooperation; and

(d) Mobilize additional resources for development and technical cooperation.

The activities of the UNDP Development Study Programme take different forms such as seminars, lectures and informal discussion groups. Participants at the various events held under the auspices of the Programme are drawn from among high-level national policy makers, government representatives, senior officials of the United Nations Development System, leaders of public and private enterprises, representatives of the media and academics, etc.