THE
LINGERING DEBT CRISIS

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The contents of this book do not necessarily reflect the view of the North South Roundtable or any other organization with which the authors are connected. The authors are solely responsible for their views..

The Lingering Debt Crisis
Edited by
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ABBREVIATIONS AND ACRONYMS

ASEAN -Association of Southeast Asian Nations
HIS - Bank for International Settlements
CGIAR - Consultative Group on International Agricultural Research CIEC -Conference on International Economic Cooperation ECU - European Currency Unit
EFF - Extended Fund Facility [GATT-General Agreement on Tariffs and Trade
GO - General Capital Increase
GDP - Gross Domestic Product
GNP -Gross National Product
IBRD - International Bank for Reconstruction and Development I
IDA - International Development Association
IDB - International Development Bank
IFAD - International Fund for Agricultural Development
ILO - International Labour Organisation
IMF -International Monetary Fund
LDC - Less Developed Country
LLBOR - London Interbank Offered Rate
NIC -Newly Industrialized Country
ODA - Official Development Assistance
OECD - Organisation for Economic Cooperation and Development
OPEC - Organization of Petroleum Exporting Countries
SDR - Special Drawing Rights
UNCTAD - United Nations Conference on Trade and Development
UNDP - United Nations Development Programme

PREFACE

In the summer of 1983, when the developing world was groaning under the triple pressures of.huge external debts at variable interest rates, volatile exchange rates and a depressed world economy leading to adverse terms of trade, the North South Roundtable held the first of a series of meetings on the world monetary, financial and human resource development issues. The first meeting took place in Istanbul to address the issue of the external debt problems of the developing countries and to make the first attempt at

arriving at some internationally agreed solutions. Crisis of the SOs came out of that first meeting and drew the attention of the world toward the professional work that the North South Roundtable had initiated to help prepare the ground for an eventual convening of an international conference on monetary and financial issues.

For the second meeting of the series, the North South Roundtable went to Santiago, Chile in order to involve several Latin American countries which were going through the adjustment process. The Santiago session focused specifically on the adjustment process - the efficacy and equity of it, the role of the IMF in this regard and economic, social and political costs to the countries of such adjustment. The volume Adjustment with Growth came out of that meeting.

The current volume The Lingering Debt Crisis is a product of the third session of this Roundtable on Money and Finance which took place in Vienna on September 10-12, 1984. The main themes of the Vienna Roundtable were the issues of debt renegotiations, linkage of the resolution of debt problems with freer and expanding world trade, and the continuing impact of the debt crisis on human condition and human resource building in developing countries. The session was attended by about forty leading monetary, financial and trade analysts, development professionals, private bankers and national and international policymakers from developed and developg ing countries.

The volume contains papers presented at the Vienna Round table. In these papers the authors give their personal views which should not be attributed to the organizations with which they were associated at the time of the meeting.

The volume has been divided into four parts. Part I discusses the extent and magnitude of the debt problems as it affects the sovereignty of countries (Alit Ferrer), North South relations (France: Stewart), employment in LDCs (Francis Blanchard), and human development (Uner Kirdar). The main features of LDC debts are " presented by Dragoslav Awamovic in chapter 1.

Part II deals with the issues of debt renegotiation experience of several countries. From the experience of big countries like Brazil (Cants Langoni) to those of small- and medium-sized ones (Christine Bindert), the part contains chapters on overall lessons of Latin American debt renegotiations (Richard Fletcher), on IMF role in debt management (Azizali Mohammed), and on a banker's view on debt renegotiation practices (Roy Takata, Jr.). There was an interesting debate on global vs. case-by-case solution to debt problem which is summed up ably by Sidney Dell at the conclusion of part II.

It has become increasingly apparent that if the developing countries are to resume positive growth and the world is to recover from the current crisis, financial issues cannot be addressed in isolation from trade issues. Thus, the issue of linkage of solution of debt problem to liberal world trade was addressed at the Vienna Roundtable, and part III contains some perspectives on this issue - from GATT (M.G. Mathur), the World Bank (SJ. Burki) and UNCTAD (S. Abrahamian). Gustav Ranis contributes a chapter concerning how some countries, particularly in Asia, have been able to overcome the debt problem through trade expansion.

Part IV starts with a bold (practical?) proposal by Mahbub ul Haq in an effort to seek a concrete solution to current crisis. Excerpts from speeches by Kurt Waldheim, Bradford Morse and Bernard Chidzero are presented. in chapter 17. Vienna Statement is reproduced in chapter 18. Workshop reports are appended.

The North South Roundtable is grateful to the co-sponsoring organization, UNDP Development Study Programme, for the Vienna Roundtable and for this volume. The Roundtable also gratefully acknowledges the support provided by the Austrian government, the Rockefeller Foundation, the German Marshall Fund of the U.S., and the Vienna Institute for Development.

This process of creative dialogue on world monetary, financial and human resource development issues that the North South Roundtable initiated at Istanbul and has continued through Santiago and Vienna will go on until we create a conducive climate for an international conference on money and finance to take place. We'hope these volumes will make valuable contributions to policymakers who are searching for those ideas and proposals which can best promote maximum and equitable growth of the world economy. It is with this hope that we present this volume.

April, 1985 Khadija Haq
Islamabad.

Part I
Crisis Revisited

.• the debt has become a depressive and chaotic factor that subordinates national policies to uncontrollable external factors. The dilemma facing our countries is ... whether or not they are sovereign nations to decide their own destiny."

Aldo Ferrer

CHAPTER 1
Debts: Salient Features
Dragoslav Avramovic

Introduction

Five questions are discussed in this note:
(a) how widespread are the debt servicing difficulties;
(b) what is the current status of adjustment efforts in main debtor countries;
(c) is the present debt burden sustainable;
(d) how adequate are the new arrangements with Mexico (1984) for the solution of the debt problem; and
(e) can the interest burden be cut and, if so, how.

Debt Troubles: How General?

Between 60 and 70 percent of the debt of developing countries is owed by those who are either currently experiencing debt servicing difficulties, or are undergoing IMF-agreed adjustment programmes necessitated by debt difficulties, or are at present negotiating with creditors for debt reorganization.
The percentage look different if viewed from the population side. China, India, Indonesia and Pakistan, have had no debt servicing difficulties in recent years: combined they account for 62 percent of the aggregate population of developing countries; their debt, however, is under 10 percent of the total debt of these countries. As a broad generalization, most debts of Latin America and Africa are experiencing difficulty, while those of Asia are not. There will, of course, be differences of views as to the degrees of difficulty.

Progress in Adjustment

Eight of top twenty developing-country debtors either did note have to go through adjustment (India, Indonesia, Algeria, Turkey, Egypt, Indonesia, Pakistan), or sailed through it quickly and without major pains so far (South Korea). Together, they account for debt aggregating US $160 billion (see Table III).

Table 1
Long-, Medium- and Short-term Debt, Disbursed, 1954

Debtors in difficulties(billions of U.S. dollars;

Latin Amencal	344
Afrlca2	

Asia	100
Southern Europe	30
Total debtors in dlfficultlea	20
Total estimated debt0	494
Debt Owed by debtors In diPoCUltie, as	810
percent of total estimated debt	61%

1/ Except Colombia, Paraguay and Trinidad and Tobago.
2/ Except Algeria, Egypt, Tunisia and Zimbabwe,
3/ World Bank estimate, end-Ion debt,

Sources: Inter-American Development Bank, Linens Debt and Economic D4ye opnent in Latin Amefea, January 1984; UN Economic CommlnIM for nose of Africa,, Countries May 1984; Dr. Alwyn B, Taylor, The Debt Service of Africa in the I990s, April 1984; DECD, EXbme/ Debt O/Deve/Op/ngCOUntdx, I9883uNey, 1984; oridSank, Debt endtheDeveloping WOrld,January 1984.p reports.
Debtors in difficulties

Table 2

Long-and Medium-term Debt, Disbursed, End-1982

Debtors In difficulties	
Low-Income African countries	
Middle-IncomeOil-Importing aounMes2	23
CIIaxportH 3	226
Total debtors in difficulties	102
Total estimated debt	351
Debt owed by debtors in difficulties as	519
percent of total emulated debt	68%

1/ Twenty-four countries.
2/ As listed by the World Bank, excluding Colombia, Greece, Jordan, South Korea, Paraguay, Thailand and Zimbabwe.
8/ As listed by the World Bank, excluding Algeria, Egypt, Indonesia, Malaysia, Trinidad
d Tobago, and Tunis!..

Source. World Bank, op.cit.,CECD,Opcit.

Table		
Major Debtors: In Adjustment or Otherwise (debt outstanding figures in brackets)		
(billions of U.S. dollars) Total debt Outstanding (by country groups)	Total debt Total debt (by all major countries)	
No special adjustment required:	India (20)	
	Indonesia(20)	
	Algeria(18)	
	Turkey (16)	
	Egypt(16)	
	Colombia(11)	
	Pakistan(9)	
Rapid and apparently successful Adjustment:	South Korea(40)	160
Adjustment: under IMF Programmes:	Mexico (90)	
	Brail(100)	
(Phase I of debt arrangements)	Yugoslavia(20)	120
No IMF programmes :	Argentina (45)	
	Venezuela(35)	
	Nigeria(20)	100
Last group	Philippiens(26)	
	Israel (24)	
	Chile (21)	
	Peru (14)	
	Portugal (14)	
	Marocco(11)	110
		580

The two largest debtors, Brazil and Mexico, and Yugoslavia managed to improve substantially their balances –of-payment through sharp devaluations,and reduction of investment, employment and living standards. In all three production revived somewhat in 1984 , mainly under a successful export drive, but the pressutes on employment , real wages and inflation remain heavy. These three countries had IMF programmes and are now candidates for long-term rescheduling (Phase II of debt arrangements).They account for debts of US $ 210 billion.

No agreement (as of August 1984)with the IMF proved possible so far in Argentina and Nigeria (debts of US $ 65 billion). Venezuela (US $ 35 billion) prefers to carry out the adjustment without the IMF, helped by its large foreign exchange reserves; it is renegotiating debts with the creditor banks directly.

The last group of large debtors consists o£ countries experiencing acute external and internal strains, under the combined impact of commodity price shocks and domestic pressures: Chile, Israel, Morocco, the Philippines, Peru and Portugal. They account for US $110 billion of debts.

This story would not be complete without reference to Eastern European debts. Three large debtors - Romania, Hungary and Eastern Germany - underwent a rapid adjustment and managed to turn around their balances-of-payments. The economic cost is not fully known. They account for about US$ 30 billion of debts. Poland is still in difficulties, accounting for another US$ 30 billion.

Is the Present Debt Burden Sustainable?

Two pieces of evidence show the continuing and heavy strain under which the debtor countries operate. First, debt restructuring programmes in 1983 involved about US$ 72 billion of debt service obligations, either overdue or soon to fall due, compared to US$ 6 billion in 1982, according to an IMF estimate} The latter is probably an understatement, perhaps because of the difficulties of definition. Secondly, and despite restmcturing, arrears on external payments continued to list in 1983 and reached US$ 27 billion at the end of the year, compared with US$ 25 billion at the end of 1982 and US$ 7 billion at the end of 1981. Forty-two countries were having external payments arrears or government defaults at the end of 1983. The third piece of evidence was the stagnating or falling real income in a number of countries, in some for the third consecutive year.

The Mexican Arrangement 1984: Amortization

The agreement of the Committee of creditor banks with Mexico, whose outline was published in the fall of 1984, is a step forward in solving the debt problem. It envisages a multi-year rescheduling of amortization due in 1985-1990: the six-year total of US $69.30 billion is now reduced to US $16.54 billion, a postponement of more than US $50 billion. The rescheduled amounts will not be maturing in the following eight years 1991-1998. The aggregate fourteen year rescheduling period comes dose to the proposals made earlier this

Table 4
External Payments Arrears of IMF Member Countries

	Arrears (million SOBS)	Number of countries
1976	1,753	20
1977	5.140	23
1978	4.962	23
1979	5.474	26
1980	5,268	30
1981	6,207	35
1982	22.638	38
1983	25.781	42

Source: IMF Survey, op. cit.

year by the Latin American regional economic organizations. There is no debt rescheduling fee - an immediate saving to Mexico of US $500 million which, as was the practice earlier, otherwise be payable. The interest rate margins (spreads) on account of "country risk" have been reduced from the level charged duringthe crisis of 1982-84, but they are higher than before the crisis. An original, but •risky, element of the Mexican rescheduling is the right of the non-US creditor banks to convert up to one half of their Mexican dollardenominated loans into loans denominated in their own national currencies, i.e. German marks, Swiss francs, Yen etc., at the going exchange rates within a predetermined period. This will reduce the immediate debt service of Mexico as the interest rates on nondollar loans are on the average lower than the dollar rates; but as the exchange rate for the dollar is now extremely high, the conversion will result in correspondingly high amounts of debt principal, expressed in note-dollar currencies. The trouble with this is that the new principal is irrevocable, while interest rates fluctuate and may turn against Mexico. The creditor banks wanted the conversion as they did not want to face the prospect of refinancing their dollar deposits over a long fourteen year period, clouded by exchange rate and interest rate uncertainties of unpredictable magnitude; holding debts and refmancing of deposits seemed less risky if done in their national currencies.2 The debt problem has become a part of the international monetary problem; the switch to nondollar-denominat-ed international debt claims is in fact a step in

internationalization of the monetary system; its net effect on the debtors depends on the conversion rate and future exchange and interest rates of major
world currencies, over which the debtors have little influence unless the management of the international monetary system is substantially changed.
A multi-year rescheduling of debts is of importance in view of an enormous bulge in principal repayments looming ahead in the next few years.

The Continuing Interest Rate Problem

Interest rates have remained largely intact in the Mexican settlement, however, and it is the interest burden which is now formidable for many debtors. The creditor banks cut sharply the spread on account of country risk from 1-7/8 percent above LIBOR (London Inter Bank Offer gate, or the base rate) to 1-1/8 percent, in the Mexican arrangement; but this concession is largely swamped by the level of the base rate, the LIBOR itself, which was running at I2-1/4 percent (six-months term) at the end of August 1984. The total rate Mexico pays thus remains close to 14 percent, unless LIBOR were to change substantially. Furthermore, interest rates on official export credits of industrialized countries were just raised by 1.2 percent p.a. across-the-board, resulting, effective 15 July 1984, in a new range of 10.7 to 13.6 percent p.a., depending on the income class of the borrower. Only some international financial agencies have managed to keep their lending rates under 10 percent p.a., although this normally involves an exchange risk for the borrowers of unknown magnitude.
This level of interest rates has four effects:
(a) It absorbs as much as 40 percent of export earnings and close to 30 percent of domestic savings of the major debtor countries in Latin America and the Philippines; in countries like Chile and Peru, it absorbs one-half of domestic savings; in Africa, which has obtained concessional finance, the average effective interest rate is now as high as 6-7 percent because of the very high cost of market and suppliers credits borrowing;
(b) By draining such large resources, it reduces creditworthiness over the short-run of the indebted countries, thus holding down their new capital inflow;
(c) A resulting lack off resources is a major obstacle to resumption of investment. Furthermore; onlyy a limited number of existing foreign-financed projects can yield the present
rate of interest; and if they have been financed at floating rates or on short-term, the burden of servicing has to be shifted to the general taxpayer. The resulting deceleration of growth and a reduction of living standards tend to reduce creditworthiness over the long-run; and
(d) As "soft" funds, such as IDA, are scarce, a growing number of poor countries are compelled to resort to borrowing on commercial terms in rising amounts; the higher the.gsarket rates the smaller the number of projects which can be financed or the greater the risk of debt servicing difficulties
at a later date; a wiser course of action may be-to refrain from new investment, but this carries the penalty of growing unemployment and social strain.
The problem is aggravated by falling export prices of developing countries, partly under the pressure of their own export efforts aimed at earning foreign exchange to pay for debt service and vital imports. Falling export prices, whatever their cause, raise the real interest rate paid by the debtor above the nominal rate. This is the case today. Commodity prices, after a partial recovery in 1983 from the 1981-82 slump, are again on the decline since early 1984; prices of manufactures exported by developing countries fell some 16 percent between 1981 and 1983; and it would be surprising if the weakness did not continue into 1984 in view of their strenuous export efforts.

Can the Interest Rate be Cut?

Dr. Kaletsky, of the Financial Times, recently proposed the following scheme to be applied to major debtor countries:
(a) 4 percent, i.e, four percentage points of a total o£ fourteen percent per year on debt outstanding, to be paid to creditor banks in cash foreign exchange as before;
(b) 6 percent is capitalized by the banks in the form of new loans to the debtors;
(c) 2 percent to be paid to creditor banks out of proceeds of loans extended to debtor

countries by a newly established IMF-IBRD facility, which would insist on "a sweeping programme of growth-oriented microeconomic adjustment measures"; and

(d) 2 percent would be absorbed by creditor banks through reduction of their profits .[3]

Dr. Kaletsky's proposal has the merit of trying to slice the problem in an attempt to make its solution easier. The trouble with it is that it might force losses on creditor banks, which would make them reluctant to resume lending, perhaps for a considerable time. Furthermore, the developed country governments are not in a mood for creating a new facility to provide debt reorganization finance, and the debtor countries are not anxious to see a long-term close involvement of international institutions in controlling their economic policies. Capitalization of interest over an indefinite period would lead to snowballing of debts and perhaps their ultimate repudiation, debt at 6 percent doubles in twelve years. There is no mechanism in Dr. Kaletsky's scheme which would induce the developed countries to expand their imports from the debtors and thus facilitate their debt-servicing problem; and there is no benefit to the poor developing countries which are only now entering the borrowing process on a large scale and have to face a 14 percent rate.

Earlier this summer, I prepared a scheme which proposed the following slicing of interest (the components adding to 14 percent on debt per year):

(a) 3 percent payment in cash foreign exchange;

(b) 2 percent payment in local currency, to be adjustable downwards (with a corresponding adjustment upwards of the 3 percent slice payable in cash foreign exchange) if trade restrictions on developing country exports are relaxed or their access to programme loans and SDRs allocation improved. The local currency accruals would be usable for on-lending and sale to other foreign parties. Countries which do not permit foreign banks to operate may drop this option and pay the 2 percent in cash foreign exchange, in addition to the 3 percent under (a) above; and

(c) The balance of 9 percent i^ capitalized by the creditor banks into new loans to debtor countries, but for a tempoy rary period of a year or so. During this period, joint studies and negotiations are conducted by the developing and the developed countries, with the help of international agencies as required, as to the ways and means of reducing the international, i.e, worldwide rates of interest. The future of this slice, beyond the year, will depend on the outcome and progress of this inter-governmental work.°

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depend on the outcome and progress of this inter-governmental work.°

The particular percentages listed above are illustrative: they are negotiable magnitudes. The fundamental points the scheme is intended to convey are two: first, a way must be found for a transition from the present unsustainable real rate of interest of more than 15 percent p.a, to the long-run sustainable real rate - historically the latter amounted to 2 percent p.a., and secondly, the matter of worldwide interest rates is the province of governments and their joint study and cooperation.

Other schemes are possible. Two useful compilations of many existing proposals, one prepared by the Commonwealth Secretariat and the other by the Amex Bank Review, are instructives Most of these proposals face three constraints:

(a) Governments of developed countries, in their present budgetary difficulties and a philosophical mood, have not been willing to consider allocating new budgetary funds for the solution of the debt problem. The main exception has been the last increase of IMF quotas and the General Arrangement to Borrow, but these are emergency and quickly repayable funds.

(b) Governments of developed countries have not been prepared to consider "monetization" of the debt of developing countries or a part of it, through, e.g, issues of SDRs for this purpose, partly on philosophical grounds, and partly because of fear of resumption of inflation; and

(c) Governments of developing countries have tried to avoid hurting the creditor banks as the latter were and potentially are a major source of funds and are even now the main supplier of trade finance; hence all proposals to place the existing loans on the market for whatever price they can bring and to force the banks through non-service to do it, have not been seriously considered.

On the Eve of Phase 11

The ad-floc IMF•BIS-central banks-export credit agencies arrangement, created in August 1982 to provide emergency assistance to debtor countries on conditions of retrenchment, or Phase I of debt arrangements, was based on three assumptions:

(a) A fairly quick injection of funds will prevent any unravell ing of international credit and a threat too the banks and the monetary system, and will help the affected debtor countries to turn around their balances-of-payments in a fairly short order. This assumption has proven correct, although the social and economic cost was heavier than was probably anticipated;

(b) A country agreement with the IMF wifl lead, in short order, to a resumption of ww market lending, and the collapse of 1982 will I1e a quickly forgotten incident. This assume Sn turr{ed out wrong an far, and it is not yet clear when and to what extent will the capital market resume lending to thee affected countries; and

(c) luternational interest rates will fall as inflation decelerates. They did fall sharply between August 1982 and the following summer, and this provided relief; but then they turned upwards again, and as international prices fell, the real rates ale now as high as ever. This was totally unexpected, and it remains our main intellectual puzzle and policy problem.

In their economic substance, debt reorganization and enforcement of claims are the issues of settling the accounts concerning past economic mistakes and unforeseen developments. They refer to redistribution of income and assets. It is a pity that in this process of enforcement there frequently occurs a ruin of production, investment and development: the society is then paying twice for the same economic error, because the real economic damage was done when the wrong investment was made attd the real resources were squandered. There is no fundamental need to pay the same price twice; and it should be possia;e tp avoid if the settlement of accounts is done fairly and peaceful y. pethaps in Phase II we will be more lucky than in the past.

1/ IMF, Annual Report on Exchange Arrange pp and Exchange Restrictions 1984, as reported in IMF Survey, July 16, 1984.

2/ The above account is b,wed on repopts published in International Herald Tribune, September 19, 1984; Financial Times, September 12 and 14, .1984; The Times, September 12, 1984; and La Monde, September 11 1984.

3/ Anatole Kaletsky, A Way Round the Debt Crisis, Financial Times, August 9, 1984.

4/ Dragoslav Avramovic, Foreign Debt and the Financial System, distributed at the'Internation2l Congress on Economic Policies: The Alternatives for International Crisis, Rio de Janeiro, August 12-17, 1984.
5/ Commonwealth Secretariat, The Debt Crsis and the Wgrld Economy, Report of the Expert Group chaired by Lord Lever, Appendix 2.2, July 1984; The Amex Bank Review, LDC Debt: The NextPhase, June 1984.

CHAPTER 2
Debt, Sovereignty and Democracy In Latin America

Aldo Ferrer

Debt and the Orthodox Strategy

Impossibility o f Increasing the Trade Surplus

The foreign debt of Latin American countries cannot be straightened up within the traditional adjustment of international payments. Statements to the contrary are mere wishful thinking. They demonstrate the present international order's inability to cope with fundamental problems as well as the dilemmas facing the economic policies of debtor countries. It is indeed impossible to generate, under acceptable conditions, the surplus in trade and in the current account balance-of-payment required to pay the debt services. Such impossibility spawns from several converging factors.
Firstly, the amount of debt and the level interest rate. Indebtedness has reached unprecedented proportions with respect to relevant economic variables. Latin America's foreign debt currently represents 40 percent of the GOP and 3.4 times the value of exports. In turn, the interest rate deflated according to the U.S. price index amounts to 7 percent per annum, against a 2 percent average during the past three decades. The real interest rate is even higher if adjustment is made according to the terms of trade of non-oil exporting Latin American countries. The real interest rate thus measured reached 20 percent in 1983. Thus, on interest debt have come to represent 35 percent of Latin American exports in 1983, as compared to 12 percent in 1977.
Secondly, the change in relative prices of exportable products does not generate, under the present world market conditions, an increase in exports. Currencies of the main debtors have been devalued strongly during the past two years. The physical volume of Latin American exports increased by 8 percent between 1981 and 1983, but their value declined by 10 percent. Price deterioration in foodstuffs and raw materials and the protectionism of central countries restrict the debtors' exports and impair their terms of trade. The latter are now at their lowest level since the 1930s. Under such conditions, orthodox strategy does not promote exports; it only succeeds in depressing salaries, production and employment.
Thirdly, a trade and current account surplus is only achieved with a reduction of imports, but this cannot be kept up any longer. Between 1981 and 1983, Latin American imports have been reduced by over 40 percent and this currently affects essential supplies for inputs and capital goods. It is estimated that an import reduction of US$ 1 billion brings about a drop of US$ 3 billion in the GDP.
The external adjustment in Latin America is truly exceptional. In 1983 the region paid interest and profits, net of new capital inflows, for US$ 30 billion This is equivalent to about 4 percent of the Latin American GDP and to 50 percent of the region's net savings. The above transfers have been financed by tightly squeezing real wages and standards of living.
Contrary to the general assumption, Argentina's external adjustment has been stricter than in other countries of the region. Between 1980 and 1983, imports dropped by 57 percent in Argentina, 50 percent in Mexico and 30 percent in Brazil. In the 1981-83 period, payment of interest and profits, net of net capital inflows, represented 32 percent of Argentine exports, 17 percent of the Brazilian and 22 percent of the Mexican ones. On the other hand, Argentina began the adjustment process after a long stagnation period. Per capita product in Argentina in 1983 was 15 percent lower than in 1970, while it grew in Brazil (60 percent) and in Mexico (30 percent) in spite of the contraction of recent years.

The Latin American per capita product dropped by 10 percent between 1980 and 1983, unemployment grew everywhere and inflation more than doubled. These indices show the tensions imposed by an adjustment process that, in spite of its intensity, is hardly sufficient to pay part of the interest. The Latin American debt rose by 20 percent between 1981 and 1983. Particularly, the rate of inflation's upward movement is related to the difficulty in generating, through fiscal policy, the necessary surpluses. Consequently, inflation becomes the instrument for depressing the real income levels and creating a surplus in the balance-of-trade.'

The above reasons explain the non-viability of the orthodox adjustment process, that is, the impossibility of generating, under tolerable conditions, the surplus required to pay the debt services.

Who is Responsible for the Crisis?

Furthermore, today's scenario of Latin American indebtedness includes a novel element in international finance: the necessary adjustment is undetermined. Contrary to what happened in Latin America in the 1930s, most of the current indebtedness consists of commitments at a floating interest rate. In the 1930s, the debt consisted of fixed interest rate public bonds and, therefore, the amount of services was known. At present, two-thirds o£ the debt consists of bank loans with rates adjustable according to changes in the international cost of money. Thee interest rate variations constantly modify the debt service. A 1 percent increase in the interest rate represents, for Latin America, an additional burden of about US$ 3 billion In Argentina, the amount is US$ 300 million which is equivalent to 2 million tons of wheat and, measured in terms of beef, to 60 percent of current exports. Whatever the magnitude of the effort, adjustment is undetermined and unlimited. Under such conditions, debtors are subject to the fluctuations of the international situation and have lost control of their main economic variables.

Thus,the insability of the international system constitutes a further factor contributing to invalidate the orthodox adjustment process. The situation spawns from the behaviour of the system's central country. The richest economy in the world which, in addition, issues the currency that is the principal asset of international reserves, is an upsetting factor of the contemporary world order. The U.S. fiscal deficit amounts to US$ 200 billion. This, plus the strategyy of curbing inflation by restricting money supply, with the conse quent rise in interest rates, generates a strong absortion of funds from the rest of the international financial system and generalizes the increase of interest rates. Moreoyer,it causes the revaluation of the U.S. currency. The dollar was revalued, with respect to 10 other principal currencies, over 50 percent between 1980 and early 1984. Hence the loss of competitiveness of the U.S. economy, its trade deficit of US$ 100 billion and the attraction of foreign capitals which, according to an estimate made by the President of the U.S. Federal Reserve Board, in 1984 will amount to US$ 80 billion. For other industrial countries, the current behavior of the American economy seriously complicates management of their own internal economies but, at least, it improves their competitive position, even within the American market itself. For the indebted developing countries, the American policy is an uttet ta1atNity~ The rise in the rate of interest and dollar revaluation increase debt services, foster protectionism in developed cddiitries and deteriorate the terns of trade of Latin American exportables. thus, the debt has become a depressive and chaotic factor that subordinates national policies to uncontrollable external factors. The dilemma facing our countries is, then, whether or not they are sovereign nations to decide their own destiny.

Lastly, we should note that the orthodox adjustment process lacks the essential equity elements to justify it. There is little doubt that debtors are partly responsible for the difficulties they are facing. Revaluation of national currencies, permissiveness with respect to transnationalization of financial systems and other factors explain, besides, facts such as oil price increases, the indebtedness of certain countries. In others; such as. Argentina, the monetarist aggression and the authoritarian regime created the worst possible scenerio: destruction of productive capacity and impoverishment by means of speculation, squandering, purchase of weapons and other follies. But this is only a part of the story. (We have just seen the responsibility of the U.S. fiscal and monetary policy in this crisis.) Simultaneously, the creditor banks' lending policies were no less misguided

during the 1970x, They granted loans without any restrictions on application of the funds and expedited implementation of bad policies or of frankly predatory strategies in the debtor countries. After 1981, they drastically cut down the flow of credit, pushing the adjustment exports of countries to unbearable levels. During the euphoria of the seventies the banks lent without any restriction and then withdrew when credit was most needed to ailow recomposition of international payments. Their behavior aggravated the instability of the world's financial and economic system. The American public opinion in this respect is more realistic as regards the banks' responsibility, than public opinion elsewhere.
In conclusion, the crisis is the responsibility of three parties: the debtors, the central countries and the creditor banks. But the price of adjustment is being paid solely by the former. Besides, the refmanang agreements impose additional fees and charges that have increased the banks' profits. The debtors, no doubt, have to pay for their own mistakes, but they cannot undertake the con sequences of the central countries' policies or the creditor banks' practices. This element of inequity in the adjustment process vitiates the viability of the orthodox scheme.

Allocation of Domestic Resources

Traditional Experience in External Adjustment.

The Latin American indebtedness and the prevailing trends inn international economy have radically modified the behavior of the n's foreign payments. Traditionally, the Latin American balance of-trade has shown deficit and, adding the net payment of profits and interest, an even greater deficit in the current account. During the 19703, the trade deficit represented 10 percent of the region's total exports and the current account deficit amounted to 8 percent of the Latin American GDP. The,net capital inflow financed the deficit and even allowed an increase of international reserves.
The Argentine case was different. Traditionally, Argentina had a trade surplus which exceeded payments of profits and interest and generated a current account surplus. Normally, Argentina is a net exporter of capital, measured by the current account of the balance-of-payments. In the 1970s, the trade surplus was 16 percent of the value of exports, and the current surplus was 0.1 percent of the GDP. This does not mean that the country-been subjected to external restriction. On the contrary, oscillations of production and income levels are largely explained by periodical crises in foreign payments. On the other hand, the trade surplus was influenced by policies of import restriction caused by insufficient exports. This acted as a restrictive factor in capital formation and growth. The problem worsened after 1976, under the impact of monetarist policies. During this period, export of capital was largely financed with foreign indebtedness.

Recent Changes

The external debt crisis brought about dramatic changes in Latin America's foreign payments including Argentina. In 1980 the region suffered a trade deficit of US$ 7.4 billion and in 1981 of US$ 1.6 billion. After the crisis, the change was astounding. In 1982, there was a trade surplus of US$ 9.7 billion and in 1988, of US$ 91.2 billion. In the latter year, such surplus represented 36 percent of the region's total exports. The incidence of profit and interest pay ments turned the trade surplus into a current account deficit. Anyway, the latter dropped from US$ 40.4-billions to US$ 8.5 billion between 1981 and 1983; and the net capital inflow, which traditionally financed the trade and current account deficits, dropped from US$ 38 billions to US$ 4.5 billion in the same period. Thus, deb services are now paid out of actual transfer of resources from Latin America to the rest of the world.
In Argentina, the change was equally dramatic. The trade surplus grew from US$ 710 million in 1981 to US$ 2.7 billion in 1982 and US$ 3.9 billion in 1983. The net capital inflow during the period covered only 40 percent of the interest and profit payments. The transfer of resources out of Argentina during the last three years represented 33 percent of exports and 3 percent of the,GDP.
Financing of international payments has thus changed radically. Currently, it is not a question of maintaining a mass of foreign investments and indebtedness whose services are financed with new capital inflows, but of transferring domestic resources, the size of

which is spectacular and is financed with a lower standard of living and decreased capital formation, thus mortgaging the long-term growth capacity of the country.

The Focal Question: Allocation ofDomestic Resources

Indebtedness has, thus, ceased being a problem of financing international payments and of flow of capital and foreign assets and liabilities, to become a question of use of each debtor country's own resources; in other words, a problem of allocation of domestic income between debt payments and local consumption and investment. Domestic policymaking is constantly preoccupied with the question of how much domestic resources should the debtors appropriate to meeting its foreign commitments. The adjustment strategy refers to how should these resources be allocated, not how can the debt services be financed with foreign funds. Under such conditions, from the point of view of Latin America, at present the ideal situation would bee that debtors import as much as they export and that creditors collect as much,as they lend. This shows the deeper nature of the current problem of foreign financing in our countries. For quite sometime in the future, until the prevailing tendencies change, what debtors will be discussing with their creditor banks and the IMF is their national economic policies and allocation of their own resources. Never before has there been such a high degree of foreign meddling in the domain of national economic policies.
Therefore, it is not enough to define the nature of adjustment policies, and whether they are recessive or not. What we have tc define is who decides the economic course and whether Latin American countries still have the right to choose their own destiny.

Debt and Alienation

Allocation of Domestic Resources and Self-Determination

Indebtedness, a problem of allocation of domestic resources, has seen its gravity center moved to international financial centres. The leading characters of the debate are the governments of debtor countries, creditor bankers, the IMP and, occasionally, the U.S. Treasury, The usual forums where the allocation of the debtors' own resources is discussed are New York and Washington, It should not surprise us that, under such circumstances, the words "debtors must" take the place of the more realistic approach "debtor can" pay up to such limit.
Accordingly, there is a need to recover the gravity center of a problem that is being debated in terms of the debtors' own resources.In this connection, the nature of the adjustment polity should be decided, in the first place, by the leading parties of each country: their governments, workers, businessmen, political parties, i.e., the vital forces of each nation's society. The local sphere should be the central frame of reference where each nation decides what to do with its own assets and its own future. The officials responsible for economic, policy would thus avoid their painful, and frequently frustrating, pilgrimages, to international financial centers. They could then devote closer and deeper attention to internal determinants of development, welfare and capital formation. The distribution of public officials' time between international financial negotiations and domestic problems is indeed an example of wrong allocation of human resources. In other words, the problem of indebtedness should be brought back to the domestic arena. If recessive schemes prevail, it is not difficult to foresee that social and political tension will finally bring back the indebtedness problem to the local framework, under the worst possible scenario: chaos and rash decisions and breaking-up of international relationships.

How to Defend Sovereignty

Indebtedness should be regarded as an important problem within the strategy of development, income distribution and external adjustment. Such decisions belong to each country, to the extent that it desires to effectively exercise itsnational sovereignty. But is this possible? Is it truly feasible to set indebtedness within the framework of economic policy of each country and its national aims? The answer to the above questions requires attention on two main facts: availability of resources and the present framework of inter-

national relations.

As regards the first matter, we should note that all debtors are living below their own means, their domestic resources. A restatement of the debt problem and a restriction of debt services to amounts that are compatible with growth and the improvement of living standards, involves increasing, not decreasing, available resources. It is a question, for instance, of reducing the transfer of resources from Latin America, from US$ 30 billion, in 1983, to a substantially lower amount. According to my estimates, in the Argentine case no more than 15 percent of exports can be applied to debt payment if we want to reactivate the economy and increase employment, real income and exports.

This proposition of relating foreign debt payment capacity to a percentage of exports is gaining followers in central countries and in Latin America and, curiously enough, even among certain exponents of orthodox thinking. The proposition has its advantages: First, it relates to debtor country's effort to the world market's behavior and to the results of policies implemented by the industrial countries; and Second, it extends repayment terms every time interest rate increases raise debt services. These are two effective ways of sharing the cost adjustment among debtors, banks and central countries.

In the Argentine case, restricting interest payments to 15 percent of exports would reduce the transfer of local resources to about US$ 1.5 billion. This means that domestic resources would be released for local investment and consumption.' In Latin America, the restriction of interest payments to 15 percent of export income would reduce the transfer of resources from US$ 30 billion (in 1983) to US$ 15 billion. The difference represents 2 percent of the Latin American GDP and 20 percent of the region's net savings. In

payments with the countries' own resources, priority should be given to commercial debts, in order to maintain a smooth flow of trade and financing thereof. The financial debt could become subject to service rescheduling programs.

Is this possible in the present framework of international relations? There are two main reasons that lead to a positive answer. First, the global nature of international problems and the growing conviction in thee financial community and political groups of the industrial countries, that Latin American indebtedness has no solution along the traditional course of adjustment. The vulnerability of creditor banks due to the degree of exposure to their debtors, the responsibility they share in generating the crisis and the role of the U.S. fiscal and monetary policy in the present disarray of the world economy, evidence the weakness of creditors to push their debtors beyond a certain point. The agreement made last March 30th to settle Argentina's interest arrears comes to show that heterodox formulas can be found to solve factual situations. As none of the debtors intend to default, but require debt rescheduling in terms that are compatible with its foreign payment capacity, it is unlikely that creditors turn to lawsuits and embargoes, with respect to creditss that, finally, will be somehow rescheduled. There is no credibility in the apocalyptic thesis of international isolation of any debtors who may assert their right to sovereignty and self-determination, and yet who keep up their commitment of gradually paying their obligations. Indeed, the industrial countries themselves are interested in preventing the present disorder in the international economic and financial system. In extreme situations, the creditors show little inclination for adopting unreconciliable attitudes towards debtor countries. We are thus faced with an affluent external context where debtors have considerable maneouvering space. Second, the fact that, as the principal debtors are living on their own means, they cannot be pushed with the threat of being cut out of supplies essential for their development. This is particularly evident in the Argentine case. A country with food surpluses, approaching energy self-sufficiency and with a substantial trade surplus, indeed lives on its own resources. Argentina cannot be cut out of supplies. Domestic consumption and investment are lower than the GDp.3

Accordingly, it is necessary and feasible to frame the indebtedness problem within national strategies for development, income distribution and external adjustment. It is possible and essential to eliminate the present alienation of the debt problem from domestic concerns of the debtor countries. Furthermore, this is the only way of avoiding major disturbances in international economic relationships. The surest course towards default is to insist on orthodox adjustment strategies.

The Latin American Crisis

The Preexisting Situation

Why, then, is this alienation in the foreign debt treatment? This being a problem of allocation of domestic resources, what are the reasons for this phenomenon? I£ the international context is able to absorb responsible and nationalistic policies of debtors, why such panic S-a-vu an eventual and non-viable punishment from the developed countries? What is it that prevents debtors from internalizing the indebtedness problem, determining the amount of maximum effor possible and resuming management of their national economies?
The answers exceed the framework of economic analysis. Economic variable explain only part of the debtor countries' behavior. The debt has laid bare deep tensions enrooted in national societies and in the prevailing development models. With or without foreign debt, the capital formation and concentration of income prevailing in Brazil and Mexico during the expansion phase or recent years, are no longer viable. It appears no longer possible to keep sustained high growth rates based on income concentration, leaving vast social sectors deprived of the fruits of development. The State's hypertrophy and the overwhelming bureaucratic power, impairment of the creative activity in private initiative, the absence of efficient responses to the most urgent social needs while resources are squandered in luxuries and drain of capitals, represent a type of behavior that is inconsistent with self-sustaining development and external equilibrium. The debt is one, only one of the aspects of the crisis found in such patterns of development. The entire process of accumulation, of technological change, of integration of regional economies, of public sector participation in the economic process is to be questioned. And such questioning covers the social and political models of each national society. Thus, we find claims for greater participation, assertion of freedom as an essential value of our culture, rejection of manipulations serving the interests of elites and jeopardizing nations' interests.
In Argentina, the monetarist calamity had burst even before the debt crisis emerged on the international scene. Domestic economy was subjected to a process of despoliation and impoverishment, quite unprecedented in the country and in Latin America. The downfall of the authoritarian political system was evident before the debt crisis and even before the Malvinas conflict. The country was already searching the road to institutional restoration and solutions for the deep economic and social crisis unleashed_ by the monetarist aggression.

The Mechanism of Denial and Displacement

Under such conditions, it is not unusual that foreign indebtedness has become an excuse to deny these societies' domestic problems. We live in a paradoxical world - a world where the external framework deeply influences the behavior of each national society.
However, it is internal problems - the cultural patterns of each people, their political systems, domestic aspirations and conflicts - which act as dominating factors in each country's development. The foreign debt has come to upset the internal setting of our countries' essential problems, displacingitby the scene of international financial negotiations, where not one single problem, including indebtedness, tan find a solution at present.
The mechanism of denial and displacement of the gravity center from the inside to the outside also operated during the prosperous '60s and 'lOs. Certain Latin American governments adopted critical and combative positions attempting to achieve a new international economic order. However, they showed considerable inability to achieve local changes to satisfy even part of their own claims within the world system. The internal obstacles to change were displaced outwards.
With or without foreign debt,, with or without the IMF, it is essential to put the domestic situation in order and balance the budget, redistribute income, carry out fiscal reforms, reorganize financial systems, curb inflation and adjust international payments. Europe, after World War H, showed the political energy required to introduce monetary reforms that uprooted the bases of fiscal unbalance and inflation. It also had the capacity to establish internal political commitments to surmount, during the reconstruction and take-off phase, the struggle for income distribution, and the admini-strative ability to keep international payments under strict control until exchange reserves and the exporting capacity could be restored. It is true that the United States' behavior helped these goals,

but this would not have been enough without domestic effort.
This we do not find today in Latin America. The fiscal and monetary reforms, intended to face the crisis, do not meet our peoples' most urgent claims. There is a weakness to face actual problems which is now masked by the debt problem and its displacement to the forum of international negotiations where there is no effective solution to the problem. Under present conditions, indebtedness is essentially a question of allocation of domestic resources between interest payments and local consumption and investment. This displacement of the debt's gravity center leads us to assume that, from the outside, we are subjected to restrictions, to rigid negotiating positions of creditors which might be modified if debtors were to show a different attitude.
During the crisis of the 'SOs, and particularly during the phase of imports substitution after World War II, the principal Latin American countries achieved substantial progress in dismantling obsolete economic structures. They partly succeeded in surmounting the traditional dependence on primary exports, integrating industrial production and the territorial space, incorporating technological change, training human resources and strengthening the policies
concerning administration of resources. Product growth, domestic savings and the relative weight of industry, the growing productivity in primary activity and the formation of new social sectors related to expanding areas, reveal the deep changes achieved in the region. It is true that new problems and new obstacles appeared which partly frustrated autonomous administration of national policies. But the breaking-up of the multilateral trade and payments system after the crisis of the 'SOs and the consequences of World War II largely emancipated fiscal and monetary policies from the old bounds of the gold standard. During the past 50 years, Latin American countries have failed to overcome deeply rooted underdevelopment and poverty, but have multiplied their production, savings and capital accumulation capacity. Real resources available today compose a different picture from that of three or four decades ago. The principal countries of the area today have the necessary means to face the crisis and assert viable development models and remedy the most urgent social problems. Why do they not do it and why are they trapped in the unsolvable dilemmas of indebtedness?
When government is in the hands of minorities within the framework of authoritarian regimes, understandably, there is no vocation to promote growth and redistribution of power and income. In such cases, the orthodo; recipe is the appropriate course to consolidate the prevailing situation. The foreign debt is an excellent argument to justify its application.
Transformation within the framework of democracy is a more complex task. It implies reconciling actions in pluralistic societies where the democratic tradition is weak, and is burdened with the social tensions of underdevelopment. Hence the apparent weakness of democratic governments to act with the required energy and efficiency. Hence the displacement of the causes and solution of the crisis to the external context.

Threats to the Right of Self-Determination

But such mechanisms of denial and displacement of the debt's gravity center from the inside to the outside is extremely dangerous. Our countries are now trapped in the expansion, hypertrophy and transnationalization of the international financial system. Today the characteristics of the.debt are such that they constitute a great threat to national sovereignties and our peoples' right of self-determination. Because it is not a question, like in the '50s and '60s, of applying temporary adjustment programs which in a short term will restore the equilibrium of international payments, the issue of foreign indebtedness will stay with us for a long time to come.
The denial mechanism delays solution of and hence aggravates our problems by increasing recession, unemployment and poverty of fundamental sectors of our societies. How long shall we be able to deny such realities and continue discussing in New York, Washington or Paris the policies to be followed and transferring to those forums responsibilities that are basically ours? We are faced with still another vicious circle typical of underdevelopment: as it is difficult to put some sort of order in the domestic situation, we go to international negotiations under the worst possible conditions - conditions that greatly reduce our own available resources, further complicating basic domestic problems. This scheme cannot be followed for much longer.

The principal problem of Latin American foreign indebtedness today does not he with bankers or the IMF. It lies with the failure to assume problems as they actually are. Incorporation of debt within national strategies for development, income distribution and external adjustment, can create more or less severe tensions with the international financial community. But the risk of incurring in arrears in order to avoid further depression of national economies iss much smaller than the danger of further straining social and political conditions. The latter is riskier, even for creditors.

Democracy and Sovereignty

The only realistic response is to improve the mechanism of democracy and, in this context, to incorporate the foreign debt as a focal problem, but only as one of the challenges facing our countries. It will be impossible to recover the right of freedom and self determination if the essential internal changes are not carried out.°

The international context is flexible enough to absorb responsible and nationalistic propositions from. debtors. The orthodox conviction is crumbling in the industrial countries and even in the international financial community. If no global answers are found, it is due to the veryy inertia of events and to the OECD countries' difficulties in solving the major dilemmas o£ the world economy. It is inconceivable that policies of self-reliance, restricting debt payments to what is possible and funding the rest of the debt with medium- and long-term securities, may cause a break-off in international relations. On the contrary, industrial countries and international banks would be induced to admit the reality of facts and to proceed accordingly.. But while our countries keep denying the deep essence of their conflicts and problems, we cannot but expect the bankers, the IMF and other leading characters of the developed world to adhere to traditional schemes. Indeed, the voices criticising orthodox adjustment methods are more daring and realistic in developed countries than in Latin America. If the rules of the international game do not change, it is largely due to the debtors' failure to assume their responsibilities and their possibilities of development based on their own resources and domestic potential. It is not a matter of following autarkistic policies, but of focusing development models on each country's local reality and possibilities. In this context, the Latin American dimension and cooperation in the subject to foreign indebtedness and other areas, can play a significant roles

These are essential dilemmas in the democratization process that is spreading in Latin America. Minorities cling to orthodox schemes, and would do so even if there were no foreign debt. This is particularly evident in Argentina's case, where the old elites of the pre-industrial system and of financial speculation want to lead the country back to the system prevailing before 1980 and to sub ordinate the productive structure to the financial sector. For these groups, the debt is a splended argument to insist on the impossiblity of an independent national policy and to claim subordination in order to survive and avoid collapse. Hence the considerable successful attempt to terrify the country with threats of embargoes, blockades, supply shortages and other calamities that would befall if we fail to sign blindly whatever may be imposed by creditors. But in the end, the problem lies in the national forces' own weakness to envisage problems on their real bases and to use the tremendous potential of democracy to achieve transformation. The possibility of paying our foreign debt without sacrificing our future will depend on surmounting such weaknesses within the national majorities and on realistic adjustment and development programs.

I/ For analysis of this inflationary adjustment process in Argentina, see, A. Fewer: "La Reforms Financiers, de la Cesacion de Pagos a Ia Argentina Viable". Comercio Exterior, Mexico, November 1983. Also: "Viva con to Nuestro", El Cfd Editor, Buenos Aires, 1983.

2/ On such basis and on some reasonable assumptions of world trade and interest rate behavior, Argentine GDP could grow at an annual rate of 5 percent and be able to pay, towards the end of this decade, all interest due and part of the principal. I owe this point to comments by Mr. B. Hopenhayn.

9/ For example, see on this issue: T.O. Enders and R.P. Mattione: "Latin America, the crisis of debt and growth". Brookings Discussion Papers in International Economics. WashingtonD.C.,December 1988.

4/ For alternative approaches to orthodox adjustment strategies, see, for Brazil: C.

Furtado "Nao a recessao a ao desemprego, Paz e Terra", Rio de Janeiro, 1988; and R. Dombusch: "A stabilisation program for Brash" (mimeo), 1988. For the Argentine case, see by the author: "Nivir con to nuestro", op. cit.
5/ A. Ferrer: "La deuda externs y la convergencia latina a iberoamericana", paper delivered at the Seventh World Conference of the International Economic Association, Madrid, September 1988. Reproduced in Comercio Exterior, Mexico, December 1989.

CHAPTER 3
The International Debt Situation and North South Relations

Frances Stewart

Introduction

Little progress has been made on major North-South issues during the past few decades. This lack of progress has occurred despite a consensus among many observers (most recently exemplified in the Brands Commission Reports) of a mutual interest in both North and South in various reforms. Deeper analysis of the nature of the interest involved in North-South relationships explains why this is so. The mutual interests identified by those advocating reform are of a very general type, while the sort of interests that determine government attitude towards negotiations and reform tend to be rather nationalistic and those of particular powerful pressure groups, which dominate any 'general' interests. An example of this occurs in relation to trade, where the general interest in free trade is evident, especially among consumers, but particular producer group (workers and managers/owners) often succeed in securing protection. Examples in other areas abound: for instance in relation to the arms trade, or to the world food situations
In order to make progress in identifying obstacles to reforms in North-South relationships and in formulating proposals with more likelihood of success, it is necessary to examine the particular interests involved in each of the major issues, and how they would be affected by various reforms. It is not sufficient to identify some general interest in reforms. However, this is not to argue that because particular interests are so important there is no room for imagination or creativity in analysis or action: Rather imagination is needed, but it must be consistent with the underlying interests. In the absence of any vision, the world may muddle through more or less efficiently, with occasional catastrophes. Imaginative ideas which bear no relationship to underlying interests will not change this, as we have seen in connection with the Brands proposals. However, where visionary ideas build on the underlying interests, changes may be achieved which produce substantial improvements. The Bretton Woods system was an example of this; Marshall aid another. In both the interests of the U.S. economy concided with a system which promoted world welfare. It is this matching of interests and vision which has been lacking in proposals for North-South reforms in recent years, and which is needed in future analysis.
The debt situation has recently become of critical importance to the stability of the world economy, as well as to the prospects of particular countries. Like other North-South issues, it has long been a subject of discussion, with a profusion of proposals for change- As with other issues most of the proposals have come to little. This paper will examine the debt issue from the point of view of the particular interests involved, in order to permit a greater understanding of current developments and to identify which reforms incorporate a sufficient element o£ particular interests to be worth pursuing with a reasonable chance of success.
Section III of this paper defines the major actors involved in the debt situation and considers their objectives and likely responses. But before doing so it is helpful to understand the evolution of the debt situation and, in particular, why what appeared to be a stable situation with capital flowing from North to South has developed into a crisis situation in which capital is flowing, in many instances, from South to North.

Background Analysis

A fundamental concept necessary for understanding the evolution of the debt situation, and the reaction of different actors to it is the basic balance. The basic balance of a

country is defined as the net foreign exchange inflow (or outflow) associated with its international borrowing. This basic balance consists of the difference between the net capital inflow and interest payments on existing debt. The net capital inflow is the difference between the gross inflow and amortisation on past debt. The size (and sign) of the basic balance is very important because it represents the foreign exchange the country is gaining, in the period considered, from international capital flows.

The net capital inflow, Fn, may be expressed as a rate of increase of total' foreign debt, so that if total foreign debt accumulated over the past is D, and d is the percentage rate of increase of this debt, then,

$$Fn = d. D$$

Interest payments on past debt are equal to the average rate of interest, r, times the outstanding debt; D, so that total interest payments consist of r D. The basic balance is the net capital inflow less interest payments, or

$$d D - r.D = (d - r) D \qquad \text{... (1)}$$

The basic balance will therefore be positive or negative according as d or r.

When a country first accumulates foreign debt, the rate of increase, d, may be very high since the base is very small and foreign borrowing forms such a small proportion of total finance. But as foreign finance comes to form a high proportion of total finance d naturally starts to fall. Ultimately a limit to the rate of increase in foreign owned capital is set by the rate of increase of the total capital stock, at the point at which foreign finance forms such a high proportion of total finance that either the national government or the foreign lenders do not wish to increase the proportion further. Hence any country where foreign borrowing is a significant source of finance can expect to have a rapid rate of increase in the stock of foreign capital initially, but subsequently some slowdown is in-evitable. A slowdown in d can, therefore, be expected in the nonnal course of events without any special factors. However, the rate of increase of foreign debt may also slow down sharply (and even become negative) for a variety of special reasons, such as world recession, or a loss of confidence in the country's repayment capacity. As the passage of time elapses from when substantial borrowing first starts heavily, the rate of amortisation rises, which requires a higher gross inflow (or rollover) to maintain a given net inflow. This in itself does not necessarily cause a slowdown in the net inflow, but it gives rise to the possibility of sharp fluctuations in the net inflow, making confidence factors more important. Whether or not these confidence factors do cause a significant reduction in d depends on many factors. Three are especially relevant to the analysis: first, the debt situation of the country resulting from its own past borrowing and the burden this imposes on the country's foreign exchange position. Secondly, a country's past development strategy which determines its potential to earn the necessary foreign exchange to service the debt. Both these factors influence beliefs about its servicing and repayment capacity. Thirdly, the world environment with respect to markets, commodity prices and capital flows may change in such a way as to lead to changes in d. While the last factor is common to all borrowing countries, the first two differ between countries, explaining why some countries have suffered more from withdrawal of confidence than others.

The other element determining the basic balance is the interest rate payable on past debt. This depends on the type of debt incurred (official or private), since different interest rates are payable on different types of debt; on the course of world interest rates, and the extent to which debt has been inured on a variable interest basis; and on the margin the country has to pay over and above LIBOR.

As is well known, after being very low in real terms for most of the 1970s, interest rates rose sharply and have remained high (with some fluctuations) rising again in recent months. The impact of the rise in interest rates was made worse - especially for some countries - by the increase in the proportion of private debt as a percentage of the total, and the increasing proportion of debt subject to variable interest rates, as indicated in Table 1.

Table 1
All Borrowing Countries

Private debt' as proportion total	Debt with floating Intareat as % fatal

1973	34.6	11.6
1978	45.6	27.8
1982	49.8	37.5

* Inpludel only Publicly guaranteed debt.

Source: World Debt rabies. 195354, World Sank.

The portion of debt subject to floating interest rates varies substantially among countries. Low-income countries - with only
a small amount of borrowing from financial markets - have a very
low proportion which did not increase during this period. Latin American countries have the highest proportion, rising from 23.8 percent in 1973 to 62.0 percent in 1982. Interest rates on average rose from 6.6 percent in 1973 to 11.0 percent in 1982 for all debt,
and from 9.0 percent to 13.1 percent on debt from private creditors.

The basic balance changed from being substantially positive in most cases to a low, or in some cases negative, figure because of the coincidence of a number of factors;

(i) a natural slowdown in d as foreign borrowing proceeded;

(ii) a rise in the average value of r because of rising interest rates, an increasing proportion of private debt, and an increasing proportion of debt subject too floating interest rates; and

(iii)a slowdown in private flows because of confidence factors, arising from the world economic situation and the build up of debt in particular countries.

That the basic balance should become negative after an initial period of sustained and substantial borrowing when it was positive is not surprising, nor unreasonable. Borrowing with interest implies that the total to be repaid, if added up, will exceed the sum initially borrowed. However, the emergence of a negative basic balance can nonetheless create problems, especially in certain circumstances. Very high interest rates may - as they appear to have done recently - bring on a situation of negative balance prematurely. If countries whosee basic balance, is negative are still patently underdeveloped as compared with lending countries then the world resource flows implied contradict the direction which would appear desirable, involving poorer countries running trade surpluses, producing more than they consume, while richer countries may consume more than they produce. This situation may all the same be acceptable to countries whose past development strategies have made it relatively easy for them to achieve a trade surplus. (as for example, Taiwan today). But countries whose past strategies have been heavily import substituting may find the switch to achieving a trade surplus very difficult, consequently facing acute foreign exchange problems and being forced to undertake severely deflationary policies to achieve the trade target required by the basic balance. The situation is likely to be more unacceptable if it-occurs - as is likely for reasons given above - at a time when there is an unfavourable international environment, making a turn round in the trade position particularly difficult.

It is important to distinguish those cases where the basic balance has become zero or negative because of the underlying situation - viz, the slowdown in d to below the ruling rate of interest - from those cases where short-run confidence factors have been responsible for a sudden, but quite possibly temporary, fall in d. In the first type of case, the basic balance is likely to be negative over the medium-term, while in the second type a reversal of the adverse
confidence factors may again produce a positive basic balance. Countries in the first category are more likely to take a hard look at adjustment costs and to bargain toughly on adjustment conditions and rescheduling. Since they cannot expect a positive basic balance even over the medium-term, default becomes an'option. In contrast, countries whose basic balance is negative only because of temporary factors will be more anxious to reach a solution which involves a continued flow of finance. In practice, it may be difficult to disentangle these two situations, since a negative medium-term balance is likely to produce adverse confidence factors.

The expression above describing the determinants of the basic balance facilitates an analysis of the various ways in which the debt situation may be transformed. My

improvement, from the point of view of debtor countries, requires a change in the basic balance. This may be achieved by increasing the net inflow (raising d) or reducing interest payments (r). The net inflow may be expressed as the difference between the gross inflow and amortisation. Suppose g expressed the gross inflow as a proportion of existing debt and a, amortisation, then the basic balance may be rewritten:

$(g D-a D)-r D$, or

$(g-a-r) D$ ...(2)

Historically, when the debt burden became too great, the burden was reduced in two ways: (i) bankruptcies and defaults, which had the effect of reducing both amortisation and interest payments, (ii) inflation (with fixed interest rates) reduced the value of r in terms of d (since r was fixed in money terms and d rose with inflation).

Today, both these methods of reducing the debt burden have been largely eliminated. Sovereign lending has made bankruptcies and defaults much rarer, and floating interest rates have reduced the significance of inflation in lowering the burden of debt.

By ruling out both these possibilities, countries today have been put in a strait jacket which may not be acceptable when the basic balance becomes negative over a prolonged period and the costs of adjustment are high. The IMF provides short-term assistance which is relevant to countries where the negative basic balance is of a short-term nature, but does not help solve the problem of countries where it is long-term. It is among such countries for which some 'solution' to the debt problem is essential, if they are not to take radical action unilaterally.

' The next section of this paper will consider the objectives and interests of the various actors involved in the debt situation and in potential solutions.

Major Actors in the Debt Situation

There are four main categories of actors: 1. The international banks;

2. Governments of borrowing countries;

S. Governments of countries where the major banks have their headquarters;

4. International institutions.

As we shall see, there are important subgroups within these categories. It should be noted that none of the categories consists in ,h&viduak. Individuals may influence the decisions of institutions, but institutions are the effective actors. This is one reason why the normal analysis of mutual and general interests, which defines interests at the level of individual welfare, is often irrelevant to action.

International Banks: these are the banks which have been responsible for much of the lending to the Third World. They need to be subdivided into two groups; Bi: banks whose loans to LDCs form a large proportion of their total loans, in many cases exceeding their capital; Bii: banks whose loans to LDCs are of subsidiary importance to their activities. Table 2 illustrates the significance of loans to the Thud World for some major banks.

Table 2
Debt Exposure of Major Banks

	Latin American Debt N % edultv 1983	Excluding Mexico end 1983
	(1)	(2)
CWcorp	19S	124
J.P. Morwn	136	96
Bank of	164	87
CJ,.		147
Midland	189	213
Lioyaa	164	228

B9urG: (q	ICBASinking Anaiysts.
(2)	de Zoete and Seven Cuot4d In Financial Times. 3115164.

Bi: The major interest of this category of banks is two-fold: first to avoid any major default or appearance of default - hence the anxiety to avoid a situation in which Argentina's loans become non-performing while delayed amortisation, which does not get classified as default in the same way, is more readily accepted (as in the Philippines). In general these banks would prefer to.extend new credit and maintain interest payments, rather than having interest unpaid. The second objective of these banks is to maximise profitability, but this is less important than the avoidance of default.

This group of banks will (i) pressurise others to take action to help avoid defaults (including their own governments, international institutions and governments of LDCs); (ii) extend loans themselves, even if not justified on 'economic' grounds to avoid default; (iii) be prepared to sacrifice the profitability objective, as indicated by the recent 'softening' of terms on margins and rescheduling, if this is judged necessary to avoid default; (iv) treat countries differently according to the size of the stake involved in each country, but still be unwilling to see any default because of its possible significance as a precedent; and (v) have an interest in ensuring joint action so that their own finance is not threatened by the actions of other banks. Hence their desire to use international institutions to secure this.

Bii:The second category of banks have rather different interests. Being less involved their survival does not depend on avoiding default. Consequently, their concerns are (i) to maximise yields; and (ii) to withdraw their loans wherever they consider them unsafe. Their interests, therefore, may come into conflict with the first category of banks, since in the desire to maximise returns and withdraw from insecure situations, the second category could precipitate a crisis which would threaten the major banks. Hence this category of banks may be pressured by the major banks or international institutions to stay in the LDCs, despite their wishes (as with the 7 percent solution).

Borrowing Country Governments: There are important differences between countries which lead to differences in response to the debt situation. These differences include:

(i) Differences in the balance of debt borrowed from the official and private institutions. While it is the private debt situation which is primarily relevant to countries' attitudes towards this type of debt, their attitudes may also be influenced by possible implications for official flows of finance, where countries rely heavily on these. A toughh stance towards private debt might trigger off retaliatory action on official finance. This possibility may be ignored where official finance is insignificant, either in total or in terms of current net flows.

(ii) Prospects for the basic balance, as defined above. Where the basic balance is large and positive, countries are unlikely to take action which might threaten it. But where the balance is small or negative, a tougher negotiating position is. likely, especially, ar noted above, if the situation is expected to persist over a period of years.

(iii)The foreign exchange and trade position. If the foreign exchange position is strong and has been achieved by expansion of export earnings rather than drastic cuts in imports and deflation; then irrespective of the basic balance, a country is not likely to negotiate toughly on debt. A debt crisis involves a foreign exchange crisis. An adverse balance on debt, however, often causes a foreign exchange crisis. But a country which expects that it will be able to achieve the required turn around on the trade balance without excessive deflation is less likely to negotiate toughly on debt than one where the required trade surplus appears to be achievable only by sustained reductions in expenditure (contrast, for example, South Korea and Mexico).

(iv) The potential for others to retaliate on non-debt issues in reaction to action on debt. Countries which are heavily dependent on exports and/or imports, or other factors, on countries most seriously affected by their actions on debt will tend to be more cautious than countries which are more independent. For example, because of oil exports and food

self-sufficiency, Venezuela and Mexico are less likely to worry about trade retaliation than for example, Brazil whose exports (of steel and orange juice) are particularly vulnerable to possible U.S. action.

(v) Attitudes towards Fund programmes may be influenced by the potential size of Fund finance as compared with the finance a country would gain by postponing payments on debt servicing. Where the latter greatly exceed the former, the country has little to gain in the way of import finance from reaching a speedy agreement with the Fund, especially if a Fund programme is unlikely to produce a substantial net inflow of finance from other sources. Hence countries in this position will tend to weigh the costs of Fund programmes more heavily than those where they would gain substantial finance for imports by concluding a programme.

(vi) Internal politics. Even where the 'objective' circumstances are identical internal politics may differ leading to different reactions. Internal politics may differ with respect to the attention paid to local public opinion, demonstrations etc., and also with respect to the dependence of the regime on foreign support. The political bases the various regimes and how they would be affected by different strategies are of major importance in determining country reactions. Internal politics are themselves affected by past strategies, including policies towards debt, but it would be too complex and lengthy to discuss the taxonomy here.

Neighbouring Countries: because of the regionalisation effect - i.e. that lack of confidence in one country can lead to a general lack of confidence in countries in the same area - neighbouring countries, especially, if heavily indebted themselves, have an interest in how a country treats its debt situation. Consequently, they may take action to prevent a default, as in the recent case of loans by major Latin American countries to Argentina. Regional cooperation may also be sought to coordinate action so as to present a wider front to creditors. This can be of significance to the negotiating process because one important feature determining bank reaction is how much they have tent to each country, While loans to any one country are often rather insignificant, when added together the loans of a group of countries may be of major importance. This factor is obviously of greater importance for small countries, whose negotiating position, when operating on their own, is very weak. In Latin America, it is the smaller countries, such as Costa Rica, Ecuador and Bolivia which are particularly anxious to follow up the coordinated efforts of the Cartegna agreement.

Governments of Countries where the Banks have their Headquarters: overriding objective of these governments is to prevent the collapse of a major bank, which could lead to a generalised financial collapse. But they also wish, as a subordinate objective, to maintain interest payments from borrowing countries. In order to achieve their overriding objective they are prepared to pressurise borrowing governments, international institutions, and extend finance themselves. This has been illustrated by the U.S. administration's activities in recent years - e.g. with respect to the Mexican situation in 1982 and the Argentinian situation in 1984) and also in supporting an increase in the IMF quota and a widening of the General Agreement to borrow (in contrast to the niggardly attitude towards the World Bank and IDA). Perhaps not surprisingly, in view of the heavy involvement of major U.K. banks, the U.K. government has taken a much more passive role.

These governments are of course trading nations as well as £martial headquarters. Their trading strategy does not always 5 m to support their financial objectives - by giving way to protect 1st pressures, for example, they make it more difficult for borrL.ing countries to meet their interest obligations, while world recession, by depressing export markets generally, has been a major cause of the debt servicing problem. However, protectionist sentiment has remained for the most part sentiment and not action, and the U.S. has led the world, via its budget and trade deficit, in resuscitating world demand, so that the contradictions may not be as real as they appear. Nonetheless, U.S. monetary policy involving very high interest rates has been a major factor threatening the stability of debt servicing, and has thus contradicted the government's objective of maintaining £mancial stability.

The U.S. government, like that of borrowing countries, is subject to many internal political pressures, often of a contradictory nature, which explain the contradictions in polity stance.

international Institutions: these institutions-notably the IMF, the BIS and the World Bank - are the creatures of the governments which control them, and do not really have an independent existance. However, their officials do take their own line, trying to push their member governments to follow it, while in the short-run they have some independence of action. But if their policies conflict in a major way with those that the powerful governments want, then they will be pushed to one side and alternative mechanisms devised.
The MS is more obviously a creature of governments than the IMF and has played an interesting role in recent years, permitting governments to bypass the slow and stringent Fund procedures where they seem to be getting in the way, without actually abolishing them. If default is threatened because the borrowing countries have run out of cash, and they are unable to reach speedy accommodation with the Fund, the BIS can provide short-run bridging finance, and can also help to maintain pressure on the banks to extend credit and deadlines.
The IMP is concerned with short- and medium-term adjustment policies of borrowing countries so as to produce a stable financial system. Its interest in financial flows is (a) to secure the necessary finance while adjustment is taking place, and (b) to ensure that the country is following the adjustment package prescribed by the Fund.
The Fund's concern with securing adjustment means that it cannot really act as a 'lender of the last resort' providing near automatic short-term finance, because if it did so its power to enforce conditionality would be lessened. Since adjustment is needed to secure financial stability, the Fund role is supported by lending countries, and emergency finance has to be sought elsewhere (from governments themselves and the BIS).
The international institutions have the role of countering the prisoner's dilemma aspect of international debt. Some coordination among tanks is necessary, and to the extent that private cartels are prohibited, public institutions have to play the role. The Fund 'seal of approval' does this, but there is no mechanism for enforcing individual banks to respect it to the extent of extending credit to countries they consider a bad risk. Hence it is only a partially satisfactory solution. What is heeded is either more public (e.g. Fund) finance or some better way of enforcing cooperation from private banks.

Policy Responses and Reform

It was argued above that powerful particular interests are the main determinants of policy in both North and South. Section II described the evolution of the debt situation which has led to a position in which many countries have a negative basic balance over the medium-term. Putting these arguments together, in combination with the analysis of major interests involved in the debt situation presented in the last section, makes it easier to predict policy responses and assess the feasibility and desirability of various reforms.
Two types of policy response that are often discussed are default and rescheduling, the first being unilateral action by debtor countries, while the second is agreed between debtors, banks and governments. Both concepts need further clarification since both may cover a variety of measures, with different implications.

Default may involve:

1. 100 percent default with complete and apparently permanent termination of all payments of interest and amortisation.
2. Moratorium on payments of amortisation, for varying lengthy of time.
3. Moratorium on payments of interest, for varying lengths of time.
4. 2 and. S combined (i.e. moratorium on payments on interest and amortisation).
5. A write-down of total service payments to some proportion of exports, GNP or some other level, which may or may not be temporary, and may or may not be compensated for later by higher payments.

Rescheduling, involving banks and borrowing countriesrleads to a rearrangement of the timing of payments (amortisation and sometimes interest); so far it has always involved higher total payments with less payable immediately and more in the future.
It is helpful to consider all these possibilities in terms of the way in which they affect the net present value of the debt (NPVD). Any given debt may be expressed as a stream of payments of interest and amortisation which, when discounted at the ruling interest rate,

gives an NPVD.
From the point of view of the debt burden of countries, there is a crucial distinction between those measures which reduce the NPVD and those which increase it, or leave it unchanged. All the varieties of default involve a reduction of NPVD, in the extreme case (100 percent default) reducing it to zero, while in the other cases (moratorium, write-down) reducing it by varying amounts. In contrast, rescheduling, as practiced, involves increasing the NPVD by varying amounts, depending on the precise conditions, while relieving the immediate liquidity problem. Thus it may reverse a negative balance in the immediate future, while leading to a greater negative balance in the future, by which time thecountry may be in a better position to pay.
Countries with prospects of a negative basic balance over the medium-term have a strong motive to reduce the NPVD of their debt obligations, if necessary by unilateral action, until such a time as the basic balance becomes positive. But this does not imply 100 percent default. In many cases, a quite modest write-down or reduction in service payments would achieve the required turn around in the basic balance. This would represent a much more attractive option for most countries than 100 percent default since the implications for other aspects of North-South relations (e.g. trade, aid) would be much less serious. Moreover, 100 percent default would also prevent a positive basic balance, by reducing capital inflow to zero, for an indefinite period, and could lead to very strong reactions including the possibility of military action. Write-down of some sort maybe a temporary device until such a point as international interest rates fall and the basic balance becomes positive.
The major banks (and H.Q. governments) have a strong motive to avoid creating a situation in which major write-off occurs. Hence their adoption of rescheduling and support for IMF programmes. But these policies, since they do not reduce the NPVD, may leave the countries with a negative basic balance, reduced in the short term but increased in the longer-tern. They do not, therefore, represent a permanent solution in many cases as is becoming apparent with the experience of those countries who have had to undergo a series of rescheduling operations and IMF programmes. So long as the negative basic balance remains, the possibility of unilateral action to reduce the NPVD also remains. A satisfactory ntedium term solution must (a) alter the terms of the debt so that the basic balance becomes positive; (b) reduce the NPVD; and (c) improve the foreign exchange earning capacity of the country so as to meet the required debt servicing (albeit at reduced rates).
Possible solutions may be analysed in terms of expression (2) above, describing the determinants of the basic balance, viz.: (g - a.- r) - D where g, a and r are defined as a stream of payments over time.
Table S sets out thee main types of 'solution' that have been proposed. For those countries with a negative basic balance over the medium-term, only schemes that reduce the NPVD are likely to be sufficient to avoid unilateral action. Hence while the first two categories - insurance and lender of last resort schemes - could be attractive from the point of view of the Northern interest in financial stability, they are not likely to be sufficient to avoid more radical action by some Southern governments. The next three solutions - 'cap' proposals, debt for equity and high interest compensation schemes - offer relief in the short-term, but at the possible expense of greater payments in the future. However, whether this is so or not depends on the precise details of the schemes; they could be devised so as to reduce the NPVD. The debt-into-equity proposal is likely to meet overwhelming hostility from Third World governments. The final set of schemes offers a permanent reduction of amortisation and interest. These schemes, therefore, should be more attractive to borrowers than unilateral action. When considered on their own, they involve losses for the banks and the HQ govern-ments, but in terms of the opportunity cost (viz, unilateral action by borrowers) they offer gains. This type of scheme, therefore, potentially provides for a genuine identity of interest in reform between powerful groups among lenders and borrowers. It is on this category of scheme, therefore, that attention should be focused.

Table 3
Various proposals and their Impact

Scheme	Variable	Effect on NPVD	Burden sharing	Comment
1.Insurance	**Raise g**	**None**	**Little; some**	**Inadequate-**

(Wallich, Level)			**Northern gov.**	**dose not reduce NPVD unlikely to raise g much**
2. Lender of last resort (Lipton, Griffith-jones)	**Raise g**	**None**	**Little; some Northern govts.**	**As above; deals with flnancial instability.**
3. Cap: reduccing current nterest to be com-pensated later (solomon)	**Affects timing may not affect total of any variable.**	**None, unless later comp.is small.**	**Bank, tempo-rarily and possibly HQ govts.**	**Help current situation. May worsen future.**
4.Exchange	**Mainly timing**	**Asabove. Could increase NPVD**	**Bank could lose now; gain later.**	**LCD hostility likely**
5. High interest compensatory fund at IMF.	**Raise g, temporarily.**	**None, affects timing. Could Increase total**	**Govts. Temporarily.**	**Temporary solution.**
6.Exchange debt for lower interes, longer maturity (Kenen).	**Reduce a and r.**	**Reduce NPVD.**	**Northern govts and banks.**	**Attractive solution; little Northern support.**

If the present situation persists (high r, low g) it is likely that unilateral action will secure a de facto solution on these lines, as indicated by statements from a number of important borrowing countries (Argentina, Venezuela, the Philippines, for example). A negotiated de jute solution would be preferable from many points of view:
(1) because it would prevent the lurch from crisis to crisis,
which is having negative effects on world trade, financial confidence and capital flows.
(ii) the process of negotiations would offer the chance of combining some conditionality and adjustment with a solution to the debt problem.
(iii) an ad hoc solution will only secure a solution for countries in a strong bargaining position - viz, those with negative basic balance and which have borrowed enough to have a significant effect on major banks. The ad hoc solution would exclude other countries, which have major problems, but are in a weaker position to enforce a solution by threatening unilateral action.
The analysis of interests and policymaking suggests that some countries are in a much stronger position to secure an improved debt position than others. The next section of this paper will provide a tentative classification of countries along these lines. An inter-nationally negotiated solution to thee problem is needed to extend reforms to countries which are in a weak position when they negotiate individually.

Country Classification

The earlier analysis suggests big differences in countries' policy responses and negotiating strength according to their particular circumstances. One critical factor is whether the basic balance - over the medium-term - is expected to be positive or negative; another factor is the relative significance of official and private capital. One of the major determinants of a country's negotiating strength is its importance to the banking community in terns of the magnitude of outstanding debt. (There are many other relevant differences - some noted above - for example, with respect to past development strategy and trading potential, but these will not be explored here).
There is a substantial statistical problem in classifying countries. The World Bank

provides systematic data on public and publicly guaranteed debt of more than one year's duration. Table 4 below uses that data. But non-guaranteed private debt is often very large, as is debt of less than one year term. For example, at the end of 1982 publicly guaranteed and official debt accounted for 73 percent of total debt (of more than one year) in Latin Americas, with private non-guaranteed debt outstanding at US$ 64 billion, as compared to US$ 135 billion of publicly guaranteed debt incurred in financial markets At the end of 1982, short-term bank debt amounted to 19.5 percent of total debt in Algeria, 48.5 percentjn Argentina, S4.8 percent in Brazil, 57.2 percent in South Korea and 59.9 percent in the Philippiness
In many countries, the quantities are unknown- The Argentinian case provides an (extreme) example: the Minister of Finance stated in April 1984: "We still don't know the debt; there were no registers in the central bank .-- with most loans we could not identify the purpose, the amount, the interest or the grace period"- According to a report in the International Herald Tribune, more than one hundred officials were searching through stacks of paper piled six feet high.°
It is apparent, therefore, that a full knowledge of the statistics, and inclusion of all types of debt, could make a substantial difference to the country classification indicated in Table 4, probably increasing the number of countries with a negative basic balance, and also the magnitude of these balances--

On the basis of the World Bank data, Table 4 provides a country classification of countries with a negative basic balance in 1982, and records their significance to the banking community in terms of proportion of outstanding loans- 12 countries have a negative overall balance, taking official, private bank, and suppliers' credits together. Countries where the negative balance was of considerable size (over 5 percent of imports) include Ecuador, Venezuela, Gabon, Bolivia, Brazil, Algeria and Hungary.

-Of those countries with a negative overall balance, Venezuela and Brazil were highly significant to the world banking system with over 5 percent of world debt in financial markets). The other countries are of minor significance. Argentina was in a curious position, according to these figures, with substantial negative balanceon official and private banking accounts offset by positive suppliers'credits. Argentina is of major significance to the banking community.These figures are for just one year, while policy responsesdepend on prospects over a period of years. In some respects 1982
Was perhaps untypically bad, because of adverse confidence factors affecting the gross inflow as well as high interest rates. But highinterest rates look as if they are going to continue, while new lendingremains low- Moreover, the `omitted' evidence would probably increase the size of the negative balance.On the basis of these figures, it seems clear that a large number of countries have a strong motive for bargaining very toughly on debt, and considering default as one option. Of those listed, Venezuela, Brazil, Israel and Argentina are each sufficiently significant to the financial community too use this possibility to secure improved terms, reducing the NPVD.

A further 29 countries had a negative balance on financial markets, outweighed by positive official and suppliers' credits. Of these, a large negative balance on financial markets (over 5 percent of imports) was recorded in Kenya, Malawi, Jamaica, and Nicaragua. These countries would be likely to be influenced by possible repercussions on official flows of taking tough unilateral action, while none of them was of major significance to the banking system. Hence these countries are not in a strong position - either by unilateral action or negotiation - to improve their position. This conclusion applies even more forcefully to the remaining countries in the world, which have a positive balance on borrowing from financial markets.

The tentative nature of this country classification needs to be reemphasised. An AMEX analysis of 10 major borrowers, found that Algeria, Argentina, Chile, Mexico and Venezuela had a negative basic balance in the second half of 1982, while Algeria and Brazil had a negative basic balance throughout 1979-82.s The AMEX data includes short-term and unguaranteed debt.

Conclusions

The accumulation of debt by some countries, together with the high interest rates, have

led to a position of negative basic balance. Where countries are facing foreign exchange problems, and where IMF assistance is relatively small in relation to needs, while Fund programmes require substantial cuts in public expenditure and real wages, such countries are likely to negotiate toughly on debt and consider taking unilateral action if these negotiations do not succeed. At the same time, the big borrowers form such an important element of total hank finance that neither the banks nor the HQ governments can afford to face any major defaults. This is a situation where there is an identity of interests - in an operational sense - among the major actors in achieving reforms which will make the burden of debt tolerable to the debtors, while avoiding large-scale defaults. ‚Schemes which involve lowered interest rates and extended terms with lower amortisation would achieve this. Proposals to limit service payments to a given proportion of exports are a special case of this type of scheme. Some such solution will probably be achieved in an ad hoc way, without any international negotiations. However, a more formal and across-the-board scheme would be preferable because it would avoid the uncertainties involved in ad hoc solutions, and would extend the benefits of renegotiations of debt to the many countries which are not in a position to negotiate a solution for themselves. Moreover, debt restructuring may be associated with internal policy reforms. If the Fund and others wish to retain some conditionality, they should support debt reform, for otherwise the countries will come to recognise that reneging on debt is less expensive - in terms of political, economic and social costs - and brings in more foreign exchange, than negotiating Fund programmes

Table 4
Country Chlssificatim

1. Negative on All Branches

Net transfer a, % Imports, 1982X**

	Total	Official	Financial markets	Debt to financial market, as
Ecuador*	-20.5	-7.4	-12.5	1.0
Tdnldad end Tobago'	-2.1	-0.8	-1.3	0.2
Venezuela*	-5.9	O.4	-5.4	5.6
Gabon*XX	-9.1	-0.8	-9.4	0.2
2. Negative Overall: Negative on Financial (Private) Outweighing Positive Official				
Cameroon*	-3.4	1.5	-4.5	0.20
Sierra Leone*XXX	-4.1	2.4	-1.7	0.01
aollVla*	-7.2	2.2	-9.1	0.50
araall*	-5.1	1.4	-4.7	18.40
Algeria*	-9.9	1.6	-8.8	3.90
Tunisia	-1.0	4.5	-s.5	0.30
Hungary	-5.4	0.4	-6.7	0.04
Israel	-0.1	1.2	-1.2	2.20

3. Positive Overall: Negative Official & Financial Outweighed by Suppliers' Credit

Argentina	0.7	-0.2	-6.2	5.50

4. Positive Overall: Positive Official Outweighs Negative Financial Markets****

Benin+	12.0	11.3	-2.0	0.10
Ethiopia•	7.9	7.8	-0.7	0.01
Gamble'	13.1	14.1		0.01
Ivory Coast'	0.1	4.5		1.40
Kenya	0.02	8.5	-6.0	0.30
Llbesia•	3.8	5.4	-1.4	0.07
Malawi	1.9	11.5	-6.9	0.07
Mauritius	2.3	1.2	-0.3	0.07
Nlcar++	3.1	13.6	-6.0	0.09
Sudan'	14.7	16.9		0.50
Swaziland•	3.2	4.3	-1.1	0.01
Tanzania+++	11.1	11.6	-0.6	0.03
TOgo++	2.6	4.8		0.09
Uganda+++	7.2	10.2	-0.4	0.01
Zaire.	3.2	3.5	-0.7	0.50
F1J1 •	4.1	4.9	-0?	0.02
Thailand	5.9	5.1	-0.02	1.20
W.Samoa"	10.5	14.5		0
Costa Flu	3.6	5.6	-2.3	0.60
Guyana•	4.3	9.6		0.05
Halts	7.8	8.6	-0.6	0.03
Honduras'	4.4	7.7		0.10
Jasnalca•	0.8	6.6	-5.6	020
Nicaragua++	2.4	14.7	-12.3	0.40
Egypt'	4.9	3.9		0.20
Jordan'	4.0	5.0	-0.9	0.09
Syrian Arab Rep.'	0.7	1.2		0.10
pakntan	4.9	6.1		0.15
Turkey	2.0	5.6		2.10

Sourp: World Debt Tibia, 1903-04, World Bank.

Notes:

Imports for 1981.

• Supplier• credits not shown, so official plus 0nanclal do not add up total. In some caws, auppller•credits are a major factor, positive or negative.

'• imports for 1975.

X Also Hang Kong and Lebanon where import figures are not available.

°• AIW Dlboutl, Guinea Blesau, Lesotho far which no import figures are available.

XX Gabon Is negative overall and each category except suppliers credits which

1/ Frances Stewart, "Alternative Approaches to North-South Negotiations" Committee for Development Planning, December 1983.

2/ World Bank, World Debt Tables 1983-84.
3/ AMEX Bank Review, Sept. 15th 1983, Vol. 10, Nos 8/9.

4/ Quoted in International Herald Tribune, April 10, 1984 and by. F.Khilji in M.Sc. Thesis, Oxford 1984.

5/ See 3/above.

CHAPTER 4

The Impact of Debt on Employment in LDCs

Francis Blanchard

The Short-term Dilemma

Few doubt that adjustment is necessary, in the North as well as in the South, to overcome present problems and uncertainties, and to lay a sound basis for longer-term development. A most urgent and serious problem facing the developing countries is their debt burden which is creating an unsustainable external imbalance. Under such pressure, governments usually resort to measures that are both drastic and likely to produce rapid - if not immediate - results. The fight against inflation is usually based on the monitoring of overall demand, especially through a reduction of budget deficits.Deflation" and "austerity" measures are prescribed, resulting in the compression of public expenditures, including cuts in social spending. Although the cost, in social terms, has been high, the inflation rate has successfully been brought under control in a number of countries. Yet there are limits to the capacity of governments to impose austerity on their populations, and there is a growing reluctance on the part of developing countries to accept drastic deflationary measures.
In order to restore a balance-of-payments equilibrium a realignment of the national currency, i.e. devaluation, is often necessary which in some cases can place a heavy burden on the poorer segments of society. This holds true in particular where basic consumption goods and energy, including energy for household consumption (heating and cooking), have to be imported, thus increasing considerably the cost of living, especially for those population groups whose household budgets contain a high proportion of such expenditures. In addition, devaluation may adversely affect producers where they are dependent on raw materials, capital goods or spare parts from abroad.
Deflation, by a number of countries simultaneously, also means a lower global demand, and one has to expect, at least in the first stage, a corresponding reduction in the demand for labour, i.e. an
increase in unemployment and underemployment. Deflationary measures are accordingly often accompanied by measures aiming at maintaining the level of under-utilisation of manpower above the socially and politically intolerable limits. Such measures are part of what is sometimes referred to as "the social treatment of unemployment", as opposed to "genuine employment creation". It encompasses a wide variety o£ programmes, some aiming at reducing the labour supply, by prolonging the schooling and training periods, lowering the (compulsory or voluntary) retirement age, organising retraining for workers, shortening the working week, etc. Other measures aim at the direct creation of jobs; they consist of special employment programmes, such as highly labour intensive public works.

In taking immediate and short-term action needed for adjustment to a payments crisis, the International Monetary Fund has a vital role to play: it is generally admitted that it has succeeded in introducing a greater degree of flexibility into the world's financial system, without which a near collapse of the economies of a number of countries would have occurred. The Fund has been able to help countries in reestablishing the equilibrium of the balance-of-trade, so that they can meet their financial obligations.

Long-term Development at Stake

But governments, when taking such inevitable measures aiming at redressing immediate

problems, should be allowed to consider their long-term consequences. There are three good reasons for this:

Firstly, too exclusive a concentration on restoring a balance-of payments equilibrium may bias the productive system towards the satisfaction of external demand, and away from the requirements of self-reliant development. This has been particularly visible in agriculture, where industrial crops for exports have increasingly been replacing food crops, at the expense of food self-sufficiency.) The result is a more dependent, and accordingly more vulnerable, economy. The bias is all the more pronounced in that, as a consequence of internal deflation, the level of resources available for investment is reduced.

Simultaneously, as has been stressed before, measures aiming at the reduction of public expenditure usually more heavily affect the so-called social budget of a country, including the part devoted to education and training. Although the consequences of such cuts have practically no immediate negative impact on the economic performance of the country (which is why they are made), they do result in a lower level of human capital formation, and this will at a later stage be detrimental to growth and reduce the capacity for future self-reliant development. Conversely, human resource development is a crucial investment for the nations' future development, as an increased level of skills will certainly lead to higher productivity, better opportunities for industrial investment and thus more gainful and productive employment.

The third, often neglected but important, consequence of too drastic short-term adjustment measures is that, despite some emergency measures such as those described earlier concerning employment (and they will necessarily be limited in scope in view of the paucity of resources), social cohesion will be severely tested. As indicated before, if no special attention is given to their fate, it is probably the economically weaker, i.e. the poor and the lower paid workers, who will be most affected by deflationary measures '.. and cuts in welfare programmes and public delivery systems. While this often results in the short-run in popular unrest, it can well degenerate into uncontrollable situations, physical destruction, economic breakdown, and leave lasting scars - a not very propitious climate for development or for securing the confidence of foreign investors.

A Dual Challenge

Policymakers are thus facing a double challenge: (a) minimising the social cost of the adjustment measures required, and (b) designg ing those measures in such a way that they do not hamper long-term development.

Minimising the social costs of budgetary savings calls, first of all,, for a careful analysis of their economic productivity. It is an over-simplification to consider social measures merely as a "cost" to the economy. Many social programmes, as has already been indicated, have an economic rationale, either through their positive effect on the roductivity of the human factor, or indirectly through the preservation of social peace without which no real or durable economic development is possible. Analysing them from this angle provides pointers for the selection of the programmes to be cut, and also reconsidering the magnitude of the proposed cuts. There are, in addition, many opportunities for improving the "economic rate of return" of social measures, in order to obtain the same - or even better - results with less resources. This can be achieved, in many cases, through more careful programme design (in particular a better focus on "target groups") and better management. While the economic consequences of social programme cuts should be considered, the social consequences of economic austerity measures should be assessed as well. In particular, they often result in increasing un-employment, following a slow-down in economic activity, and appropriate measures should be taken both to alleviate the hardships borne by the workers and to prepare for future development. In order to be successful at the lowest possible cost in terms of employment, adjustment policies should include a dynamic approach to labour problems. Anything that can promote greater mobility of labour - whether geographical or occupational - should be encouraged. A controrio,, any measure contributing to the inflexibility of the labour market - and in particular wage rigidities and excessive job retention practices or regulations in industries that have lost their competitiveness -will in the longer-term be detrimental to economic development and to the level of activity in the economies concerned. The negative consequences, for income as well as for

employment, of protectionism, in the medium- and long terms, have been amply demonstrated on many occasions.

A social "cushion" protecting the weaker members of society and preserving their productive capacity is a basic condition for any restructuring; without it, internal political pressures will force governments, with varying success, into greater protectionism and 'beggar-my-neighbour' policies.

A progressive, effective and socially tolerable adjustment course towards a more promising pattern of development, however, can be contemplated only to the extent that the country submitted to it is given enough 'breathing space". For this are needed: a favourable international environment, access to sufficient financial resources, the rescheduling of debts over longer periods, fair prices for those commodities on which low-income countries are dependent, the abolition of protections[practices, the development of collective regonal self-reliance, and more assistance from the richer countries of the world. An increase in the international financial institutions' resources forms, of course, part of these prerequisites for better adjustment packages. And, finally, an essential condition is the adoption of realistic, efficient policies which remains the responsibility of governments.

In a long-term perspective, adjustment implies more than just changing production patterns. Tendencies are emerging towards a different relation between Man and Work facilitated in a way by the recent recession, and a new dualism has appeared in the industrialised economies, with a steadily growing "submerged sector", accompanied by more non-conventional forms of employment, such as shared work, part-time work, split jobs, etc., often based on the workers' own preference. In addition, new technologies based on micro-electronics are rapidly changing the content and conditions of work - an ambiguous change which could have both positive and negative consequences. The models generally adopted by the developing countries for their own development are changing as well and not always along the lines of models pursued by the industrialised countries.

A few guidelines concerning domestic policies can be suggested to governments for effective adjustment measures:

- reduce unproductive spending, e.g, for armament, and conspicuous luxury consumption, both private and public;
- protect the more vulnerable groups in society, i.e, the poor, young children, and the aged, by carefully considering consequences before abolishing food subsidies or services, or by at least redefining target groups before doing so; by introducing structural measures such as those relating to rural employment and development;.
- assess the economic productivity and social usefulness of programmes, and avoid cuts in those contributing most, including inter olio education, training and population programmes;
- increase labour mobility, in geographical terms, by improving conditions of work and life in rural areas, and in occupational terms by training programmes;
- aim at self-reliant development, in order to achieve (a higber degree of) food and energy sufficiency. Food production should be seen in the broader context of rural development, including also non-agricultural activities and then employment potential, as well as possibilities to improve living and working conditions in the rural areas and to contain the rural exodus.

In addition, efforts should be made at the international level
to:

- scale down protectionism and trade barriers between North and South;
- increase financial resources for investment and development, through private and public, bilateral and multilateral channels, especially through the international financial institutions and in particular by supplementing the presently insufficient IDA resources;
- stabilise commodity prices at remunerative levels, c.g. in implementing the Common Fund;
- strengthen.the dialogue and cooperation between all U.N. system units concerned with development, bringing their analytical frames under common denominators and making their action in favour of developing countries complementary and cumulative.

The foregoing analysis shows that employment, the main subject of this paper, is so central to development that it merits being chosen as the pivotal point of analysis and action. Gainful and productive employment and poverty eradication are preconditions to

achieving economic prosperity and social justice, the ultimate aims of development.
1/ There are, however, some notable exceptions, in particular in Southern and S.E. Asia.

CHAPTER 5
Impact of Debt on Human Conditions in LDCs*

Uner Kirdar

An Overview of the External Debt Situation

At present the developing countries are experiencing a very serious, prolonged and widespread economic and financial crisis. The external indebtedness is one of the most alarming causes of the present crisis, both by provoking it and by rendering each day heavier. The important and unusual feature of the current situation is the fact that all regions and in each region so many countries with such different types of economies are affected and suffering from the impact of this crisis, although to varying degrees. With few exceptions, the development process has come to a halt or even reversed. A marked reduction in new lendings, a continued rise in debt servicing owing especially to increasing interest rates and declining export earnings following weak export demands, depressed commodity prices and tightening protectionism in industrial countries are resulting in lower living standards, massive unemployment and political destabilization in developing countries.

Most Latin American countries are caught in a debt trap. Incomes have been cut sharply in order to reduce demand and meet greatly enlarged debt service payments. The imports of non-oil products have been cut down by 50 percent or more. The import cuts have reduced employment and output, and since 1980, standards of living have declined to the levels of 1970. In Brazil, for example, the average income fell by 17 percent between 1980 and 1983. The devaluation-inflation spiral has pushed inflation in some countries into three digits. During the past five years, the debt of

* The views expressed in this paper are those of the author and not necessarily those of the Administration of UNDP. The author expresses his deep gratitude to the Resident Representatives of UNDP in the countries surveyed, who have contributed valued and detailed information and data to this paper. The presentation of the information is, however, the sole responsibility of the author.

these countries increased 27 percent faster than their exports, and the ratio o£ total interest payments to exports of goods and services rose from 17.4 percent to 35 percent.

During the same period in the African countries, medium- and long-term debt increased over 80 percent faster than exports and their debt service ratio more than doubled. Moreover, these severe financial difficulties have been accentuated by crippling droughts. Incomes in most countries in Africa, south of the Sahara, have dropped below the levels of the mid-1960s. The food crisis afflicting more than 20 countries has diverted 25 percent of concessional aid into food imports. Only some of the South Asian countries have not been so severely hit by the existing external debt situation.

Until recently, in the view of financial authorities of some major industrialized countries, there had been no general debt crisis,but only a number of individual country situations. As each was sui genets cases, it was argued that each should be dealt with on an ad hoc basis. According to the Committee for Development Planning of the United Nations, such views of the problem are grossly misleading. The alarming financial situations are too numerous to be dismissed as isolated cases involving a few major debtor countries in Latin America.' Payment arrears, which had remained at about US$ 5-6 billion over the preceding five years, rose to US$ 18 billion at the end of 1982, and many countries approached their creditors for a rescheduling of debt service payments. In 1983 there was a major process of restructuring involving the commercial debts of 30 countries and the official debts of 17 countries. Through this exercise altogether some US$ 70 billion of debt service was rescheduled, which was 10 times more than that of 1981 and 1982 combined. Of the 22 largest developing country debtors 10 were Latin American, 7 African and 5 Asian.

For almost all these countries, the emergence of the heavy external indebtedness reflects a combination of unforeseen adverse external developments beyond their control and inadequate domestic economic policies and management. Starting in 1979, many non-oil

developing countries were affected by the second large increase in oil prices, the prolonged recession of the early 1980s and the rise in real interest rates. A common and important factor in all countries facing debt difficulties is the drastic change to already high interest rates. Through much of the 1970s, the low real interest rates may be regarded as a major stimulant in encouraging these countries to borrow externally beyond their limits. While high nominal rates of the 1970s combined with high rates of inflation implied an "accelerated amortization" of debt, the high ex post real interest rates of the early 1980s implied a transfer of resources for which borrowing countries were unprepared -2 For instance, the half point rise in the prime lending rate in the United States last May to 12 ½ and another half point rise a month earlier had almost overnight added US$ 600 million to the amount Argentina must pay over the next year on its foreign debt of US$ 45 billion. This provoked the Argentinian President Raul Alfonsin to call the unexpected rise "a neutron bomb in which men and women remain alive, but all that generated wealth is destroyed". He called the decision 'madness of financial centers"which inperil Agrentina's "Social Peace".

Table 1

External Debt of Non-oil Developing Countries, (1978-1982)

	1973	1979	1989	1982
Total debt odtitao7N9	(billions of U.S. dollars)			614.2
	130.1	391.1	467.6	
Debt service payments	17.9	65.0	76.2	105.0
Interut	6.9	28.0	403	573
PrlncIpal	11.1	36.9	35.8	47.6
Ratio of debt to GOP	22.4	(In percent) 26.8	26.9	35.8
Ratio of debt service to exports	15.9	19.0	17.6	23.4

Source: International Monetary Fund.

Illustrative Cases

The following country examples of different sizes, level of development and economic structures from various regions amply support the overview of the international debt situation elaborated above.

A. Brazil

Within the developing world, Brazil is the largest debtor nation with a total foreign debt of approximately US$ 91.9 bilion,4 corn pared to US$ 23.3 billion in 1975 and US$ 64.6 billion in 1980. Estimates of the debt breakdown between medium- and long term and short-term as of end of 1953 were as follows

:

Table 2
Breakdown of Debt

year	Mealumrlongtarm	Snort-term	(WI lion $ of 11.9. dollars) Total debt
1980	53.8	10.6	64.4
1961	61.4	13.9	76.3
1982	69.7	15.1	04.8

1983	79.3	12.6	91.9

What is more significant, however, regarding the composition of the debt is the fact that approximately 70 percent of it has been contracted on the basis of floating interest rates, linked to changes of the U.S. "Prime Rate" or the "UBOR" rate. It is estimated that a one percent rise in interest rates would cause an increase in payments of US$ 577 million. This in turn represents about 3.6 percent of the imports for 1984, which would have to be compensated, either through increases in exports or what is more likely, through cutbacks in imports .5

In examining the growth of indebtedness in Brazil, it is necess:1ry to go back to 1967, when Brazil opted for an expansionist formula to respond to the then ongoing recession, a period when Brazil was experiencing large unemployment and when a large part of its inoustrial capacity was unutilized. The expansionist programme was based basically on threee points: (a) large borrowing abroad; (b) a strong government programme to promote exports; and (c) a programme of incentives for savings. Initially, the programme was very successful and coincided with the "Brazilian Miracle" o£ 1967-1973 when the economy grew at a high pace of 10 percent per year and inflation levels were kept low.

It was during this period that the government, interested in taking advantage of the less expensive money markets abroad made some institutional reforms in the financial sector which were later to affect the shape of the economy, the level of control which the

Table 3

Ratio Debt Service/Export Earnings and Debt Service/GOP

(In percent)

	Oebtrxport Service/Ratio	Debt GDP Service/Redo
1980	70.1	25.2
1981	75.9	26.5
1982	95.5	28.5
1983	21.0	31.5

government could exercise in order to influence the economy, and the level of interdependence between the national banking system and the international monetary system. With a banking system able to exert greater autonomy in the creation of liquidity, savings were increasingly channelled toward an ever-increasing demand in consumer goods, mostly of the middle- and high-income groups.

The first oil crisis of 1973-1974 hit Brazil at the highest point of the economic expansion. Brazil responded to it, and later to the 1979 oil crisis, by increasing its borrowing abroad in order to maintain the growth momentum of its economy. In the beginning, this appeared to work in spite of the worsening terms of trade. In 1981, however, several factors reversed the situation: interest rates suffered a steep rise; important commodity markets collapsed, affecting many Brazilian exports such as sugar, coffee and iron ore; the world recession seriously affected the demand for industrial products; and world trade began to evidence serious tendencies toward generalized protectionism. It was against this world background that Brazil approached its breaking point in 1982, a year when the balance between its exports and its debt management no longer allowed Brazil to "roll over" its debt, and forced it into a series of rescheduling programmes.

Exports in 1982 fell by a rate of 13.4 percent and the average interest rates, (LIBOR of six months), reached a level of 15.98 percent per year plus "spread" rates of 1.61 percent, thus raising the real interest rates to 17.59 percent. This caused the ratio of debt to exports to rise to approximately 2.847 in spite of a large effort to decrease imports initiated that year.

Table 4
Ratio of Interest Payments to Exports

(In percent)

1980	1981	1982	1983
	34.1	40.1	43.5

Added to the above mentioned factors leading to the 1982 crisis was the fact of Brazil's extreme dependence on external energy sources. Having basically three available options to decrease the energy bill right after the second oil shock of 1979, namely, reducing the growth of the economy, controlling the oil consumption and substituting other sources of energy, Brazil clearly opted for the third. This, of course, implied that no immediate results were visible, but that longer-tens results would be achieved. The fact that Brazil, in spite of its large domestic market, is also one of the world's most inward looking economies, (exports constitute less than 10 percent of GDP), increased even more the country's vulnerability and added to the concern of its debt management challenges.

A simulation published by the Jomal do Brasil on May 27, 1984, shows that if real interest rates of 15 percent (i.e. 12.5 of international interest rates plus "spread" commissions) were to be the rile for the next ten years, with a ten year grace period and only then 5 percent of the principal would begin to be amortized, Brazil would have by 1994 a total debt of US$ 310 billion. Interest rate payments alone would amount to US$ 311.6 billion and needs for new resources would amount to US$ 41.8 billion.

B. Mexico

Mexico, with an estimated total of US$ 88 billion, compared to US$ 6 billion in 1970 and US$ 50 billion in 1976, is the second largest debtor nation among the developing countries.

In the 1970x, as in the 1960s, the economic policy in Mexico found a growing support in using external indebtedness as a means of financing development on a non-inflationary basis and without
major fiscal reforms. In the late 1970s a sizeable proportion of the surplus of international liquidity flowed to Mexico, as a safe and stable oil-producing country, encouraging a sharp increase in the pace off new borrowing. This served as the counterpart to the effects of internal policies that made borrowing necessary, such as the target of a very high pace of growth of the economy (8-9 per cent), the overvaluation of the national currency and the relative liberalization of imports. The dependence of the economy on oil, upto 75 percent of total exports, and on external financing- owing to the effects of the increasing burden off the debt service - made the country particularly vulnerable to external factors. In 1981-1982 these factors. became deterimental to Mexico - i.e. a fall of export prices of oil, high interest rates and a continuous outflow of Mexican capital (more than USS 20 billion) encouraged by the free-exchange regime in operation. This necessitated the urgent securing of new credits, mainly on a short-term.and hard conditions basis. When the results of the devaluation of the currency could not offset the continuous drain of reserves and the international banks stopped their supply of credit, the financial crisis broke in August 1982: an exchange control was implemented and the first rescheduling of the service of the external debt was negotiated entailing a three-month lag for the payment of interest and further renegotiations regarding the payment of the principal.

Table 5

Development of the External Debt

1970-1982

(millions of U.S. dollars)

Publlo 1970	Public 1976	Public 1983
Privet. 4,000	Pfivat 20,000	Pfivate 61-65,000'
Total 2,000•	e 8-12,000	Total 19-29,000•
6,000•	Total 60.0009	80-88,000•
•		
approxim ate figures.		

During 1983, the rates of interest in international markets remained at a relatively low level (8-10 percent) compared with those prevailing in mid-1981. Nevertheless., since the last quarter of 1983there was an upsurge in the interest rate. It is estimated that every percent of increase of increase represents an additipnal burden of about US $ 800-900 million in the interest payment that Mexico must make yearly. The amount of interest paid in 1982 was about 30 percent higher than that of 1981, while the balance of debt rose only 8 percent.

C. Chile

Between 1980 and 1983 the increase of foreign debt of Cile was about 59 percent but since 1983 the rate of increase has started declining, and this is even more evident in the preliminary estimates for 1984.
This reduction is partly due to the restricteve policy adopted by the international commercial banks, since in the course of 1983 they practically did not approve any new loans, but channeled their credits through the renegotiation process initiated in 1983 by the country. At the same time the recent increase of the interest rate (prime) of 0.5 percent during March, April and May of 1984 applied by the North American banks will probably represent an increase of the Chilean external debt of approximately 450 million dollars.

Table 6 Outstanding External debt (millions of U.S. dollars) Medium-and long-term							
Years	Total	Public	Private	Total	Public	Private	Total
1980	11.084	4.720	4.693	9.413	0.343	1.328	1.671
1981	15.557	4.415	8.138	12.553	1.065	1.939	3.004
1982	17.262	5.166	8.726	13.892	1.565	1.805	3.370
1983	17.600*			16.016			1.584
1984	17.900*						
*Prellminary figures. Source ECLA							

Interest due on the medium-and long;-term foreign debts of Chile rose to US$ 1.75 billion in 1983 as compared with US$ 912 million in 1980. In general the percentage of interest in terms of GNP almost doubled during the same period.
A higher percentage of interest payments over the country's exports was observed: in 1980 19.4 percent; in 1981 37.1 percent; and in 1982 47.1 percent.
Most of the analyses of the Chilean situation consider that the main reasons for the high level of indebtedness resides in the mal-adjustment between the commercial trade balance produced by the inflexible application of the model related to exchange fate police and the containment of international and financial markets.
While imports were stimulated, exports declined due to the fixed exchange rates. After the drop of international copper prices and the increase of interest of interest rates the Chilean external indebtedness rose to unusual levels.

D. Uruguay

As of December 31, 1983, the total external debt of Uruguay amounted to more US$ 5 billion.

The situation, in terns of debt origin, can be summarized as follow:

Table 7	
Origin of Debt by Sector	
	(billions of U.S. dollars
Public Sector	3.620 (72 percent)
Private Sector	1.392 (percent)
Total	5.012 (100 percent

During recent year, an important change has been observed in the debt structure. Its substantial increase (56 percent) from 1981 corresponds to the public sector.

The evolution of the ratio of external debt to GNP show a very grave situation: while in 1980 the external debt represented 37 percent of GNP, in December 1983 it represented practically 90 percent. From this point of view, Uruguay occupies the fifth place in declining order within the Latin American context, following Costa Rica, Nicaragua, Bolivia and Chile.

The problem is even worse, when the ratio between the external debt and export earnings is considered: in 1980, total indebtedness represented something more than two years' exports; at present, it represents more than five years' exports. In other words, from both points of view, external indebtedness multiplied between two and three times, and its present magnitude clearly shows that it is not possible to pay its servicing with normal export earnings.

Regarding the availability of international reserves, the problem has also aggravated during recent years, since before 1981 the level of reserves was higher than the gross indebtedness. At present, the rise in total debt, as well as the sharp loss in monetary reserves during 1982, determine a net external indebtedness of more than US$ 3 billion.

As the majority of the external debt is in floating interest rates, their fluctuations have an inevitable and direct impact on the total due. For instance, during the first semester of 1984, the prime rate in the U.S, market rose by 2 percent. This implied that, calculated on the total outstanding debt as of December 1983, the external indebtedness of this country rose by more than one billion dollars in only six months, making the general situation even more difficult.

E. Jamaica

During the 1950s and the 1960s, the Jamaican economy ex perienced a boom situation. Economic growth was high, based on the rapid growth of the bauxite, manufacturing and construction sectors. External financing wass an important factor in the growth process. The share of foreign investments in the total investments amounted to one-third during this period. The imports of raw materials, fuels and intermediate goods grew more apidly than the total imports. While local productive activity became increasingly dependent on imports, the imports became dependent on external financing. Government revenues rew with the general economic ex pansion. Government expenditure grew even faster and the fiscal deficit, as a proportion of the total budget, increased. Since local non-inflationary borrowing from the banking system and foreign loans were available to finance thee gap, this did not constitute a major problem.

The situation of comfortable growth and foreign debt changed fundamentally in the 1970s. Jamaica was moving towards greater financial dependence and an acute economic crisis. Several factors on the international as well as on the national scene which have contributed to the decline in the Jamaican economy can be mentioned:

- As a result of the world recession, the external sector, which used to be of vital importance, weakened.
- Growing investment income outflows and a sharp decline of the receipts from tourism led to a growing current account deficit after 1971.
- The increased world market prices of both oil and non-oil commodities put intense pressure on the balance-of-payments. However, the increased import ccsts were largely covered by the Bauxite Production Levy of 1974, imposed as a reaction to the oil price increase.
- The structure of capital inflows changed. Direct investment became negative in 1975-1976, following the termination of the investment cycle in the bauxite industry in 1971 and capital flight owing to political factors in 1975 and 1976.

The private inflows which took place were mainly commercial lending to local

enterprises; much of these loans were medium-term loans under government guarantee. The substitution of financial inflows for direct foreign investments aggravated the balance-of payments problems. Jamaica's gross external debt grew from US$ 143 million at the endd of 1971 to US$ 773 million at the end of 1979. Government expenditure grew at a high rate. A part of this increase was to finance salvage operations, loans to private enterprises and take-oven of public utilities and part of the bauxite industry. Another part was used for a broad social programme, including housing, education, wage increases in the public sector, etc. Finally, the debt service payments absorbed one fifth of a much enlarged budget in 1976-1977.

The growth of the government revenue could not keep up with the budget expenditure. Stagnating economic activity was responsible for this. Corporate income tax payments were stagnant and even declined in 1974-1975. Personal income tax showed an increase, due to the growth of money incomes. In order to contain this problem, the government imposed new taxes, especially consumption duty, and increased the transfers from the Capital Development Fund into which the Bauxite Production Levy was paid.

In spite of these attempts, the situation got out of control in 1976-1977, with rising expenditure - owing partly to fiscal expansion, partly to the political pressure of the elections - declin ing revenues and the cessation of external commercial lending in 1976. In that year, the government was forced to finance US$ 271 million of the deficit through money creation by the Bank of Jamaica.

Table 8

The Development of the External Debt

(millions of U.S. dullanl

End of Period	Market lotus	inter- national Institutions	Inter- qo arn- moot	comme r- clal banks	other wooer- dal	Total external debt
1960	25.7	168.2	320.7	266.8	64.3	860.7
1961	13.9	305,7	424.5		3203 ,26. 7	1,091.1
1982	5.0	458,5	585.5	329.3	66.7	1,447.0
1953	0.2	517.3	671.4	317.3	144.4	7,650.6

Source: Bank of Jamaica Stetlstlcal Digest.

In 1981, fom lnternauonat Institunon5 anti rarer-governmental sources recorded significant increases relative to the other categories. These two categories together increased by US$ 219.2 million. Disbursement from a US$ 71 million loan from a syndicated group of commercial banks, led by Citibank N.A., were largely responsible for the increase recorded in this category.

In 1982, international lending institutions and donor countries provided substantial financial assistance for the government's economic programme. As a result, project and programme loans recorded significant increases. The World Bank increased its lending to Jamaica by US$ 90,5 million.

During the 1980s the maturity structure of the external debt has been shortened. Unless important debt rescheduling arrangements are made, this will aggravate the difficulties of repayment since the foreign exchange situation is in a deplorable situation.

Table
Debt Sevicing Ratio

	1980	1981	1982	1983
A. Total debt service	263.3	437.8	408.4	371.4
Interest	153.0	186.6	221.7	195.3
amortization	110.3	251.	186.7	176.1

B.Gross exports of goods and services Debt servicing ratio (A to B)	1,421.3 18.5%	1,506.5 29.1%	1,288.6 31.7%	1,355.3 27.4%
Source: Bank of Jamaica.				

In 1981, there was a sharp increase in the total debt service. Both interest and amortization payments recorded increases. Amortization more than doubled. At the same time, the growth of exports of goods and services was not more than 5 percent. As a result, the debt ratio went up by about 11 percentage points.

Debt service payments declined by US$ 37.0 million during 1983 compared with 1982 because of arrangements for deferral of some payments falling due during the year. This factor, together with the increase in gross exports of goods and services, led to a decline in the debt service ratio from 31.7 percent in 1982 to 27.4 percent in 1983.
The debt servicing ratio may be misleading as it suggests that the debt is paid with export earnings. In practice, incurring new debts are often used for this purpose. The ratio between debt servicing and new loans may be a better indicator of a future indebtedness crisis.
In 1982, the debt service (US$ 408.4 million) as a percentage to the foreign loan disbursements (US$ 343.3 million) was 119 percent. A decline of foreign loan disbursements in 1983 resulted in an increase in the percentage of the debt service (US$ 371.4 million) to the foreign loan disbursements (US$ 258.8 million) to 144 percent.

F. Nigeria

Until 1977, Nigeria was relatively independent of external sources of finance. However, by 1981, a grandiose Third National Development Plan (1975-1981) had consumed an estimated N50 billion, approximately N18 billion more than had originally been earmarked. This over-expenditure, and diminishing oil revenues and agricultural production have been the major domestic factors contributing to Nigeria's present debt crisis. High interest rates and general worldwide recession have compounded the situation.
Between 1960 and 1969, external finance to Nigeria was limited mainly to bilateral grants on soft terms from Western countries (U.S., United Kingdom, Germany, Italy, etc.), and the World Bank. At this time, the grants were used for well-conceived and pursued projects. In addition, foreign equity investments, especially in the petroleum sector, were actively sought, which subsequently laid the basis for the "oil boom" and corresponding enormous revenues from this resource. During this period, Nigeria's external debt grew from N82.4 million in 1960 to N435.2 million in 1965 and then to N488.8 million in 1970.
During the big "oil boom" years between 1970 and 1976, when huge foreign exchange reserves were obtained from petroleum exports, outstanding external loans decreased from N489 million to N375 million. In fact, an indifference to external borrowing or direct equity investments developed in conjunction with the grandiose Third National Development Plan. Agricultural and self-financing industrial projects were not successfully implemented despite the oil riches, and diversification of exports was not achieved.
By 1977, Nigeria was already realizing a scarcity of foreign exchange partly as a result of the largee volume of imported food and other products of which the country had previously been self sufficient. However, by this time, the external borrowing options available to Nigeria as an oil producer and member of OPEC were much greater than before. Nigeria sought and received two "jumbo" programme loans from the Euromarket (worth US$ 1 billion and
$1.2 billion for projects in the public sector). Meanwhile, borrowing from the World Bank increased as their programme in Nigeria expanded to the extent that US$ 500 million was earmarked annually for development loans.
In general, the post-1980 scenario has been one in which trade debt arrears have mounted

as has the burden of servicing the external debt, both as a consequence of decreasing foreign exchange reserves. Specifically, the combination of an inability to decrease the country's import bill despite declining petrol revenues and depleted foreign reserves has led to serious economic consequences. Increased foreign borrowing by the state governments augmented the external debts. In 1982, one-quarter of the total public debt (US$ 2 million) was borrowed at the state level. The lack of cost control on major projects (i.e. the River Basin Development Authorities, Abuja, etc.) has led to estimated costs escalating beyond original expectations and/or schemes being abandoned in mid-stream.

As credit lines to Nigeria dried up, foreign suppliers and financial institutions hesitated to deal with Nigeria again. In essence, Nigeria's credibility on the international financial markets declined substantially. Consequently, the federal government found itself in a position whereby it was forced to refinance and reschedule trade debt arrears so that credit could be re-established, particularly for the importation of necessary food and raw materials. Two billion dollars worth of letters of credit were transformed into medium term loans at an interest rate of 1.5 percent above LIBOR. Repayment is scheduled to be made in thirty-one equal installments with a six-month grace period.

Table 10

Total External Debt Outstanding

(millions o/ U5, dollars)

	Actual 1980	1981	Estimated 1982	1983	Projected 1984
Debt outstanding and dlsbuned	4,339	6,219	8,290	11,800	18,844
Ottldal	983	993	1,151	1,816	2,611
PrIvate	3,356	5,226	7,139	9.984	16,233
Undlsbunaddebt	4,194	7,967	7,077	6,998	4,070

There was a substantial rise in the debt servicing burden of Nigeria between 1981 and 1984 with debt payments as a proportion of export earnings having risen respectively from 5 percent to 30.5 percent. This debt servicing ratio is expected to continue rising because of additional external borrowings necessary for national structural adjustment.

able 11
Total Debt Servicing

(millions of US. dollarsi

	Actual 1980	1981	Estimated 1982	1988	Projected 1984
otaldebt servlce	550	912	1,424	1,996	4,246
Interest	449	850	775	969	1,946

Table 12

Debt Servicing Ratio to GNP, Export Earnings

	Actual		Estimated		Projected
	1980	1981	1982	1983	1984
GNP/Capital(US.ddlars)	1,010	750	730	700	
Ratio of debt to GNP	4.3	8.3	11.3	16.8	
Export of goods (millions of U.S. dollars)	25,956	17,738	12,930	10,730	11,627
of 'Mach Petroleum	24,942	17,162	12,751	10,350	11,179
Payment as a percentage of exports	2.0	4.8	10.5	17.9	35.1

1 Source: World Bank Data, Central Bank of Nigeria.

The rescheduling of US$ 20 billion worth of debts over the next two years has eased the immediate burden of short-term debt which was US$ 23 billion at its peak.

External factors have certainly contributed to the present debt situation in Nigeria. Specifically, the global recession of the late 1970s and early 1980s which was characterized by high inflation and nominal interest rates has magnified Nigeria's debt problems. Uncertainty with respect to commodity prices in the world market has compounded the present situation.

C. Zambia

Zambia's financial and economic difficulties started with the sharp decline in real copper prices that began in 1975. By early 1984; copper prices were almost 60 percent lower than they were in 1974. In addition, world recession lowered demand for Zambia's copper. With copper making up 90 percent of merchandise exports, Zambia was ill-prepared for the shock. Furthermore, the oil price increase since 1979 further depressed the terms of trade for Zambia.

The government initially attempted to sustain expenditure levels and income by heavy external borrowing. External payment arrears have accumulated and today Zambia's debt service absorbs about half of its export earnings. The combination of the size of the debt and the deterioration in Zambia's terms of trade has deprived it of the foreign exchange needed to pay for imports of raw materus, the shortage of which, in turn, has affected the functioning of almost all productive sectors of the economy including mining, agriculture and transport. As a consequence, resources have also increasingly been in short supply in the social sectors. This, therefore) has had a negative impact on human conditions and human resource development.

The deterioration in the balance-of-payments situation left the authorities with no choice but to repress imports. Overall, real imports in 1978 were 57 percent of 1969 levels.

The cutbacks in the real value of imports severely constrained productive and investment activity. The effect fell across all sectors but has been most severely felt in the manufacturing and mining sectors which were most dependent on imports.

Current account deficits increased to an average of 20 percent of the gross domestic product in 1980-1982. Reserves were drawn down and the government borrowed heavily abroad. At the end of 1983, Zambia's external liabilities stood at almost US$ 4.5 billion, of which US$ 600 million was in arrears. In 1983, the current account deficit was reduced sharply to only 9 percent of the gross domestic product. The reduction in the current accountt deficit was brought about in part by an IMF-assisted stabilization programme as well as by a sharp decline in imports to a level, in real terms, of only 32 percent of that in 1974.

As of December 31, 1983, Zambia's external public debt stood at US$ 3.3 billion, with suppliers' credits comprising 10.2 percent of debt outstanding and disbursed; financial institutions 11.4 percent; multilateral loans 20.4 percent; and bilateral loans 58 percent.

A third factor for external indebtedness is the dramatic increase in the price of oil. In 1974, Zambia's total foreign exchange expend-iture on oil imports was approximately US$ 17 million, having increased from roughly US$ 4 million in 1979. Since then the govt ernment has taken steps to reduce the volume of oil consumption. As a result of these efforts, the volume of oil imports has gone down by about 90 percent. In spite of this reduction in the volume of oil imports, however, its cost has risen to about US$ 200 million. The fourth factor is the high value of the U.S. dollar, which affects not only the import bill but also export revenues, especially as copper prices are determined in sterling. Fifth, interest rates have risen. Following the changes in U.S. monetary policy in 1979, U.S. Treasury Hill rates averaged 11.6 percent from 1979 to 1982 compared with 5.8 percent from 1976 to 1978. This has raised the whole structure of international interest rates and as Zambia's debt has been rolled over, the interest burden has increased. The World Sank estimates that Zambia's debt service ratio for 1984 will be well over 60 percent of export earnings. Sixth, as Zambia's access to foreign exchange has declined, its real income and output have fallen and the tax base has shrunk. Even though tax rates have increased it still has not been possible to maintain revenue in real terms, forcing the government to borrow to finance local expenditure.

H Madagascar

The external public debt of Madagascar has increased considerably between 1978 and 1989 from US$ 900 million to US$ 2000 million at the end of 1989.' The ratio of the external debt burden to the gross national product (GNP) has gown from 14 to 70 percent.

The above period could be divided into two distinct phases corresponding to a net evolution of the nature of new commitments vis-a-vis all external creditors:

a) During the period 1978-1980, the amount of new commit ments reached an average of US$ 400 million per year. This was due to the increase of loans supplied by com mercial banks and to the hard conditions for new financing. In 1980, the average characteristics for loans was as follows: rate of interest 7.5 percent; debt maturity 17 years; grace period four years; and a grant element about 24 percent. This last figure was 60 percent between 1970 and 1975. b) Since 1981, the commitments increased slowly; the average conditions of loan terms were improved: rate of interest

2.9 percent; debt maturity 25 years; grace period 5 years; grant element 48 percent.

Table 13

Development of the External Debt

(millions of U.S. dollars)

	1978	1979	1980	1981	1982	1983`
8uppllercrerdt3	84.0	105.0	155.5	116.4	1833.52000.0	
Pinanclalinstitutlona	11.1	100.8	235.4	234.5	2648.32848.9	
Bonds	9.3	2.0	1.3	0.7	64	70
Multllataralloans	142.5	167.6	225.2	270.7		
Bilateral loans	117.9	249.9	416.9	635.3		
Total	307.8	525.3	1034.	1257.5		
GNP	2156.5	2797.6	3	2903.6		
Indebtedness/GNP	14	22	3264. 5 32	43		

e estimated.

A consequence of the external indebtedness increase has been a sharp increase in debt service payments obligations known and a decrease in constant value of export earnings. Therefore, servicing debt/export earnings ratio has considerably increased.

Table 14

Development of the Debt Servicing

				lmllllons of U3. dellan)		
	1978	1979	1980	1981`	1952`	1983`
Payment,		23.6	44.5	76.4	59.2	60.0
Interests		12.8	47.5	66.0	70.9	76.2
Total	19	36.4	66.1	141.4	130.1	139.0
Export earnlngs	425.9	448.0	455.1	354.76	352.3	332.56
OntteNlclg9/exporls	4	6	19	40	37	42

(1) estimated
• after debt restNCturin0

Given the situation, the government obtained in 1981, 1982 and 1983 a partial debt rescheduling maturity as follows: US$ 76 million in 1981, $90 million in 1982 and $173 million in 1983.
Without this rescheduling, the debt servicing/export earnings ratio would have been 61 percent in 1981 instead of 40 percent; 62 percent in 1982 instead of 37 percent; and 94 percent in 1983 instead of 42 percent.

I- Togo

Togo's outstanding public external debt as of December 31, 1983 reached 314 billion CFAF, an increase of about 20 percent over the comparable figure for the previous year and about 53 percent over 1980.
Following a sharp increase in outstanding debt over a period of five years, reaching 99 percent of GOP in 1980, new external borrowing by the government or with government guarantee was strongly reduced. This led to a decline in the amount outstanding since 1981 in terms of U.S. dollars but a rise in terms of CFAF, reflecting the strong depreciation since 1981 of the local currency in terms of U.S. dollars and other non-franc currencies (in which more than two-thirds of peso's debt is denominated). As a percentage of GDP, it reached 175 percent at end 1983.
The breakdown of outstanding debt by creditor source indicates that approximately 22 percent of it is bilateral, 48 percent from private creditors with creditor's government guarantee, 20 percent multilateral and 10 percent from private banks.
The fact that much of the public external borrowing in the late 1970s had been on commercial terms caused a strong increase in the debt service burden from the early 1980s. As a result of the accumulation of arrears and the decline of the country's credit worthiness, new commitments from private sources experienced a sharp decline after 1980. The bulk of the amounts contracted in 1983 originated from multilateral organizations.
The economy in 1983 was strongly affected by a number of exogenous factors including, in particular the recent regional drought and unfavorable economic conditions in major West African countries. These developments contributed to a decline in real GDP by 8 percent and to a significant shortfall in government revenue. Furthermore, the depreciation of the French franc, and hence the CFA franc, vis-o-ois major currencies led to an increase in the country's already heavy debt service burden in terms of local currency.
The total debt service obligations scheduled for 1984 totaled 57.5 billion CFAF, equivalent to 67 percent of project government revenue and to nearly 53 percent of export receipts.

J. Philippines

With an estimated total of more than US$ 20 billion in 1984 as compared with US$ 8.1

billion in 1978, the Philippines is among the largest debtor countries in Asia. Although its burden appears modest by the standards of Brazil and Mexico, debt repayments and interests are now eating up some 28 percent of the Philippines' export earnings. The current account deficit nearly doubled between 1979 and 1983 from US$ 1.6 billion to US$ 3.4 billion, forcing the government to draw on its foreign exchange reserves and borrow more money abroad. External debts, thus, almost tripled during the same period.

Apart from internal mismanagement, part of the reason for the Philippines' increasing deficit was the rapid fall in the prices of its major exports, such as coconut oil, sugar, copper and timber, towards the end of the 1970s. Some gains in the export of such non traditional goods of electronic semi-conductors and garments also came upon shrinking or more protected markets as the recession spread worldwide. Increasing import costs, especially for oil which accounts for a quarter of the total import bill, exacerbated by the steady depreciation of the Philippine peso, and high interest rates added further to the size of the deficit. Interest payments in 1983 accounted for 50 percent of the country's current account deficit.

Raising revenue domestically has been made increasingly difficult by a severe financial crisis in 1981, which saw a near-disastrous run on banks, a slump in the stock market and large business collapses. The economic growth rate in 1982 was at 2.6 percent less than half that achieved in 1980 (5.4 percent), and three times less that in 1978 (6.5 percent).

The bulk of the Philippines' fixed external debts are long tern, with maturities of more than 14 years on an average interest rate of 7 percent. Some 41 percent of loans, however, have floating rates which fluctuate. By country, Japan remains the Philippines' largest lender, providing 22 percent of the fixed-term credits, followed by the United States with about 19 percent. Almost 77 percent of fixed-term credits must be repaid in U.S. dollars.'

An Overview of the Impact of the External Debt Burden on Human Conditions and Human Resource Development

An overall examination of the world financial situation reveals that the cost and impact of thee present external debt burden and the remedial stabilization programmes in developing countries have been very heavy on human conditions, especially by causing high reductions in GM' wages and salaries, increasing unemployment, cost of living and food prices and curtailing the level of nutrition and expenditures for educational and social services, etc.

In an attempt to provide an accurate and objective evaluation of what has been the human cost of the present external debt situation and stabilization programmes on human conditions and human resource development, three factors have to be kept in mind.

First, even during the period of the 1960s and 1970s when a reasonable rate of economic growth was ensured in most of the developing countries, the development of human resources did not receive sufficient attention in the development process, both at national and international levels. A common belief existed at the time that successful growth could best be attained mainly through capital formation and large physical infrastructural investments. Human resource development received lower priority,, as it was considered a long-term process, politically slow and not as visible. Furthermore, it did not produce high revenue in the short-term. There was less recognition that physical capital formation could not alone produce self-reliant, self-sustaining and self-generating economic and social development. Such issues as establishing creative educational systems to meet the prospective needs, providing appropriate technical training, improving the quality of human skills in the public and private sectors, developing better management capability and capacity, increasing productivity and the capacity to respond to the changing needs of growth and new technological advancement normally have not been accorded adequate emphasis and attention.

Secondly, even when most of the developing countries were witnessing a period of prosperity in their industrial and commercial centers, social conditions were already considerably inequitable and there was a tendency to exclude large masses of the population from the benefits of growth. Many benefits of development have gone to promote the privileged consumption societies. Adequate measures were not taken to promote the process for the required structural and institutional changes, with a view to achieving a more equitable showing of the fruits of growth and improving the social well-being of the mass of the population. Similarly, necessary measures for the

development of human resources were neglected.
Thirdly, as compared to economic indicators, it is much more difficult to obtain accurate and reliable data on human resource and social development to assess the impact and human cost of the present debt situation and stabilization programmes, as they affect politically national governments, as well as concerned international organizations.

A. GNpandPer Capita Income

From the above, it is clear that one should not relate the deterioration of social situations and the development of human resources in developing countries only to one single factor, namely to external indebtedness. However, it is equally true that the present "debt crisis" and "stabilization programmes" have very seriously affected human conditions heightening the already existing inequalities owing to the increase in unemployment, the deterioration of real wages and the effects of the limitations on social benefits, and by encouraging social and political instabilities- According to the last report of the United Nations Committee for Development Planning, in most developing countries, the present financial contraction caused by external debts and the adjustment measures brought development to a halt or a reversal, involved excessive social and human costs, often with serious repercussions for nutrition, health and basic education, and lowered the already low living standards. The import cuts have reduced employment and depressed incentives to invest and the demand for production. Since 1980, GNP's in most developing countries have slipped back towards those of 1970.°
Fo. instance, in Latin America from 1981 onwards there was a sharp drop in the economic growth rate, which fell in absolute terms in 1982 and again dropped even more sharply in 7983, The per capita income for the wholee region was nearly 15 percent lower in 1983 than it was in 1980.

Table15

Latin American Growth Rate Indicator

(In percent)

	1980	1981	1982	1983
Grmsdomestlcproduct	5.9	1.5	-1.0	-33
Per capita GOP	3.4	-0.9	-3.3	-5.6
Per capita gross national income	3.8	-2.4	-4.8	-5.9

Source: "ndluetment PoiICIes and Renegotletlon of the External Debt". ECt_A, El CEPAL/SE5.20/G.17; FeprparY 1984, p.4.

As mentioned earlier, in Brazil, for example, average income fell by 17 percent between 1980 and 1970. The GDP fell by 3.3 percent in 1983. In contrast, it increased by 1.4 percent in 1982. This meant, therefore, that GOP per capita fell by 5.7 percent in 1983 compared with 1981. As for 1984 projections, the Economist Intelligence Unit of March 16, 1984 mentions that most observers expect a further downturn of some 5 to 8 percent of GDP in 1984, with gross capita formation continuing to fall well below 19805 level. Industrial production is also expected to decline by as much as 6 to 7 percent.
After four years of dynamic growth, the Mexican economy as a result of debt crisis, similarly entered into a state of stagnation, with a 0.5 percent decrease in GNP in 1981. There followed in 1983 a further reduction of 4.7 percent in GDP. As to per capita GDP, it fell by 2.7 percent and 6.9 percent in 1982 and 1983 respectively.
In Chile, the severe drop of economic activity, which had already started in mid-1981, produced in 1982 a drastic reduction of more than 14 percent of GDP and also avery significant increase in the unemployment rate, from 11.1 percent in 1981 to 22.1 percent in 1982.
As a result of the present financial situation in Uruguay, the GNP in 1983 was equivalent to that of 1977 and the investment rate declined to the 1975 level. Peru witnessed a decrease of nearly 10 percent of per capita GNP between 1980 and 1983. This was also

the casein Nicaragua.
A similar situation is also observed in indebted countries of Africa and Asia. In fact, there has been a substantial decline both in GDP and per capita in Nigeria for the last three years. In Zambia, the per capita GOP has continuously declined since 1974. The real GNP per capita in 1982 was 20 percent below the level of 1974. This was the case also in Madaga`car, Togo, the Sudan, etc. In the Philippines, since 1977 there has been a successive decrease both in the rate of growth of GOP and per capita GNP.

B. Unemployment and Consumer Prices

This pronounced economic slowdown caused by external indebtedness went hand in hand with a sharp rise in open unemployment, and in many countries the situation was further aggravated by a substantial decline in real wages. Despite the low economic activity, the increase in unemployment and decline in wages and salaries in most indebted developing countries, the rate of increase of prices during the last three years reached unprecedented levels. For instance, in Latin America in some of the main urban centres, the open unemployment rose to over 15 percent and even 20 percent of the labour force. Such was the case in Chile. The simple average rate of increase of consumer prices in the region as a whole rose from 29 percent in 1981 to 47 percent in 1982 and to around 70 percent in 1983, while the average rate weighted by the population rose even more, i.e., from 61 percent in 1981 to around 86 percent in 1982 and over 130 percent in 1983.

C. Import Restrictions

Stabilization programmes for adjustment purposes impose on indebted countries the need to drastically curtail their imports, to cut real- wages and salaries, and to reduce government spending, including those for welfare services, special programmes, and sub-sidies such as those for food, education and health care. The combination of these measures definitely creates considerable adverse effects on human conditions and human resource building, particularly for the poor segments of the population.
Between 1981 and 1983, the value of imports, for instance, in the Latin American region, owing to curtailment measures, fell sharply from US$ 98.5 billion in 1981 to over US$ 56 billion in 1983, while volume of imports during this brief period fell by almost 41 percent. The volume fell even more sharply in Argentina
And Chile (by 50 percent), Venezuela (by 60 percent in 1983 alone),in Uruguay (by over 63 percent during the period 1981-1983), and in Mexico (by 62 percent from 1981 nwards).The case was similar in Africa. During the same period, Nigeria its reduced its imports by 50 percent while Cameroon reduced its own by 25 percent.
These dramatic reductions in imports naturally affected not only the purchase of consumer goods, but also involved substantial a curtailments in the import of domestic economic activity. The import cuts in many developing countries have enormously reduce their employment rates and their output. As a result, average incomes considerably diminished and standards of living have slipped back.
For example, imports play an important role in the economy of Honduras. The manufacturing sector is heavily dependent on the import of raw materials for its functioning. As the imports have been curtailed, industrial output in turn has been reduced. The commercial sector, which worked with imported goods, recently not only cut its volume of transactions, but witnessed the closing of more enterprises. A net result was an increase in unemployment. Some estimates now put the figure at 22 percent. Meanwhile, the government, which collects a substantial amount of its revenues from the customs and sales tax, as well as income tax from the importation trade and manufacturing sectors, has faced a considerable decrease in its fiscal incomes.
A similar example could be given also from Nigeria, Which was once a rich oil-exporting country. Severe import restrictions, consequent to the decline in oil earnings, problems for the Nigerian industry, which is so dependent on imported raw materials, spare parts and foreign expertise. Many factories have either cut production or closed down, and workers have been laid off. Experts are leaving the country and industry is finding it hard to suddenly replace them.

D. Wages and Salaries

In the recent past developing countries have had a rapid expansion in expenditure. This has caused fiscal, leading to the acceleration of inflation. Therefore, a typical stabilization programme for adjusting external imbalances normally insists on curtailment in government spendings. This particular prescription is also accompanied by policies to control the increases in wages and salaries in the public sectors. It is the poorest segment of the population which suffers mostly from the implementation of the combination of these two sets of policies. These measures are also always accompanied by successive devaluation of national currencies, with the aim of making the country's concerned export products more competitive in international markets. As wage and salary increases are normally kept below the rate of inflation, both blue and white collar workers normally get poorer, and their share in thee national income is reduced. Moreover, due to the successive radical devaluation, their annual per capita incomes decrease according to international scales to ridiculous levels, creating unbridgeable disparities between the incomes of the people of developed and developing countries.

For instance, in Mexico, only during 1983 did a notable deterioration of income distribution occur, since the purchasing power of minimum wages fell 23 percent. The same year private consumption decreased by 6.7 percent and the share of wages and salaries in GM' went down from around 40 percent to 30 percent. In Uruguay, present family consumption is comparable to the one calculated in 1974. This fact derives from a permanent rise in prices which reduced actual wages and salaries to 47 percent of their level in 1971.

E. Food, Health and Education

As stated earlier, most of the stabilization programmes demand major reductions in public expenditures, largely in subsidies such as those for food and special welfare and social programmes. Thus, funds for human resource development are normally sharply curtailed.

For example, in Mexico, since the core of the stabilization programme is based on the control of the public deficit, a great sacrifice was made in 1983. A 36 percent reduction in investment in the public sector in real terms was realized compared with the previous year, as well as an 11 percent cut incurred in the current expenditures, including those related to basic services. The interest rate payments alone on external debt represented almost 20 percent of the budget expenditure of the public sector in Mexico. Therefore, during 1983 no new important development programmes began and public investment was oriented only to the termination of the ongoing ones. As compared to 1978 prices, the cost of education increased 30.8 percent in 1981, 80.6 percent in 1982 and 97.1 percent in 1983. The food prices augmented 24.7 percent in 1981, 89.8 percent in 1982 and 77.9 percent in 1983. There are no official estimates concerning levels of nutrition, but they are estimated to have worsened according to non-official sources. Nevertheless, as estimations produced for the National Nutrition Plan 1983-1988 indicate the average decrease in calorie intake of low-income groups (40 percent of the total population) in 1982-1984 is expected to be 18 percent in the agricultural sector and 10 percent in the urban sector.

In Honduras, the social services, health and education sectors have seriously suffered due to the decline in the government revenues. The government, for instance, had to cut back on hiring young medical doctors and other health service personnel, as it did not possess enough resources to pay their salaries. The same has also occurred in the educational area.

In Bolivia, severe budgetary restrictions have similarly resulted in serious curtailments in funds for human resource development. This had an adverse impact on employment, nutrition and all social sectors including health care and education. Furthermore, falling real wages have provoked strikes of all sectors including a prolonged teachers' strike, leading to further contractions in the supply of social services.

In Peru, the social effects of the external indebtedness have been grave on the whole population, especially on the lower income segment. According to the information supplied by the Ministry of Public Health, the decrease in economic yctivity in the country has resultedd in a big increase in tuberculosis. Similarly, it is estimated that the

level of nutrition level fell 10 percent below that normally required.
In Jamaica, radical changes in exchange rates had a significant impact on the economy, as well as on the social life of the people. Since a remarkable portion of government expenditure has to be made in U.S. dollars or other hard currencies, devaluations implied equivalent increases in the Jamaican dollar cost of these expenditures. During 1983 and 1984, the effects of devaluations and curtailments in government expenditures, especially in cutbacks of basic
food subsidies,, were very apparent. Basic food prices, transportation and school fees were up tremendously. hi the 1984-1985 budget, compared with that of the previous year, the subsidy on food has been reduced from $J 99 million to $J 48 million. A good illustration of the decline in the social conditions of the Jamaican population could be found in the following statement of the Nurses' Association in May 1984: "Never before have there been so many cases of anaemia, especially among pregnant mothers and the aged".
The situation in the Dominican Republic has been more alarming. Last April when the prices of basic imported goods such as wheat, petroleum and medicine nearly tripled as a result of curtailments of government subsidies, riots broke out around this most peaceful Caribbean island, leaving an estimated 55 dead and hundreds injured, and shaking the social and political foundation of the country.' o
This situation is not confined only to Latin America and the Caribbean region. Similar suffering prevails also in many African countries. For instance, incidents occurred in late 1989 in the two most stable and previously prosperous developing countries of the Magreb, namely in Tunisia and Morocco. Hundreds of people were killed in riots over price increases in two basic necessities of life: bread and education, In Morocco, during 1989 food prices alone jumped over 70 percent. Unemployment increased by 20 percent and despite a huge educational programme in areas where illiteracy is still over 75 percent, in some places nearly half the children did not go to school. 25 percent of all social services were cut, primarily affecting 50 percent of the population already living below the poverty line."
In Zambia, the proportion of total government expenditure earmarked for development activities, including education and social services, has been low and has fallen successively during recent years. The share of expenditure for these purposes declined from 46 percent in 1975 to 97 percent in 1980-1982. At present, malnutrition is also one of the country's most serious problems. Protein calorie malnutrition, caused by the critical economic situation, affects the health of many Zambians. In 1974-1975, a national urban household budget survey found that 26 percent of households received less than 1(50 (US$ 57.40) income per month. However, by spending 50 percent of that income with concern only for nutrition, they could have afforded a model balance diet. Today the same diet would have required 80 percent of the equivalent low income. In February 1983, the government removed the control on prices, maintained it on wages and salaries. Current spiralling price trends are aggravating the already difficult situation of the poor urban population.
In Nigeria, the most obvious repercussion of the external debt burden on the population is that at least 25 percent (and perhaps up to even 35 percent in the near future) of all foreign exchange reserves are being used to service the debt; thus fewer financial resources have been available for human resource development programmes (i.e. education, health, etc.). Both food prices and school fees at the secondary and post-secondaryy levels have substantially increased.
In the Philippines, government expenditures had been drastically cut at least four times before the latest devaluation in 1983 to the absolute bone. This has both long- and short-term implications. In the longer-run, it means curtailment of infrastructure development, which is basic to the improvement of the living conditions of the masses, particularly in the rural areas and-in the immediate future it means much less money for the major social services, notably health and education. According to some recent estimates almost 29 million Philippines nationals are unable to feed themselves and nearly 40 million - 80 percent of the population - live below the poverty line."

Concluding Remarks

The above long survey provides ample evidence for proving the universal character of

the present external debt crisis. As so many developing countries from all regions of the world are simultaneously suffering from the same chronical causes, it is difficult to consider the phenomena as isolated and accidental cases.

While it is possible to blame to a certain degree the indebted developing countries themselves for the errors and misjudgement in the management of their own economies, the worldwide debt crisis o£ the 80s is no doubt largely the result of a series of unforeseen external developments which have been beyond the control of these countries.

The impact of the continuing crisis and the so-called remedial stabilization programmes have been extremely heavy in terms of human cost. In particular, they have caused high reductions in GNP, lost output, depressed employment, substantial decreases in wages and salaries and serious curtailments in the level o£ nutrition, health services and expenditures for education and other social benefits. Also the price of these adjustments has normally been paid mostly by the poorest segment of the population of the countries concerned. Moreover, most of the austerity programmes have failed to take into account the necessary human dimensions and the importance of human resource building. Anal, therefore, at their implementation level, they have caused a considerable curtailment of investment in human beings.

Given that the servicing of external debts requires repayments in hard currencies, obtainable only through the export of goods and services, in most cases, the financing of human resource development projects and programmes has been treated as a low priority. Such projects and programmes, while they may be socially important and economically feasible, as they do not result in the short-run in surplus output that can be exported, have normally not been evaluated as sources for additional public expenditures. Thus, in a sense, the already prevailing misconceptions and ignorance of the importance of human resource building in the development process have been aggravated by the present debt situation.

It is, therefore, not strange that in view of the current scarcity of additional international financial resources, the important questions of how to make what is available more effective and how to manage it better did not gain the required significance. Similarly, in the midst of the confusion created by the present external debt crisis, neither the question of how to narrow the technical and managerial gap between developed and developing countries, nor issues related to human resource development in developing countries arising from adaptations to new technological advancements and high level technology, have received sufficient attention of the international community.

In this context, apart from the existing heavy debt burden, the fluctuating exchange and interest rates have seriously affected the human life of millions. For instance, the unforeseen increases in the interest rates between last February and May decided unilaterally by the North American banks, have brought more misery and poverty by adding over an additional US$ 4 billion to the crushing annual debt burden services of the developing countries. In 1988 the Latin Americans alone paid nearly US$ 40 billion for interest payments, which is approximately 50 percent of all their export earnings. The further one and one half point rise in interest rates last May has resulted for the Argentinians in an additional US$ 600 million in annual payments, equivalent to the sum of international assistance to be provided through UNDP to Argentina in the coming 30 years for human resource development programmes.

The question then arises, whether human creativity could find desirable solutions, whether instead of making gold, commodities or paper, it could make "the human being" as the centerpiece of the new world monetary system. Maybe this could be considered as a wishful dream. Nevertheless, as a Turkish poet once said, "one lives as long as one dreams...."

1 / Committee for Development Planning, Report on the twentieth session (17-21 May 1984), Document E/l984/17, p. 11.

2/ See: "Recent Multilateral Debt Restructurings with Official and and Bank Creditors", IMF Occasional Paper No. 25, December 1983.

3/ The New York Times, May 11, 1984.

4/ The Economist Intelligence Unit, Quarterly Economic Review No. 1, 1984 (Economic Structure Statistics).

5/ Economist, May 26, 1984. Source: Bank of International Settlements.

6/ Source of information: Central Bank of Chile.

7/ Source of information: South, July 1984 and April 1983, EuroMoney, April 1982.
8/ Op. cit. pp. 1-6,11-13.
9/ See: "Adjustment Policies and Renegotiation-of the External Debt" op. cit.
10/ The New York Times, April 29, 1984.
11/ Source: The New York Times, "In Morocco, a fuse is slowly burning," John B.Oakes.
12/ South, July 1984, p.68.

Part II

Debt Reorganization: Issues and Experiences

... to force debtor countries to run trade surpluses in order to meet excessive interest payments is not a restoration of equilibrium but rather the creation of one disequilibrium to offset another.'

Richard Fletcher

CHAPTER 6

Lessons of Recent Debt Reorganizations"

Richard Fletcher

Historical Perspectives

Problems between debtors and creditors are an inevitable by product of the practice of lending and have occurred from very early in recorded history. Roman Law texts, which are almost 2,000 years old, deal with legal actions to recover unpaid loans and several centuries ago Shakespeare immortalized Shylock and the "pound of flesh" - a very unusual case of debt rescheduling.

Most early debt problems were strictly private affairs i.e., between private lenders and borrowers. Sovereign loans only became common in the 19th century. Yet here again we find that debt problems occurred from time to time giving rise to a number of interesting examples of debt reorganization:

- In the 1940s, nine of the independent states of the United States of America suspended interest payments on loans they had received for building railroads and canals, when a fall in cotton prices (the main export of those states) left them short of foreign exchange.'
- In the 1930s, both the British and the French governments defaulted on their debt payments to the United States "on the grounds that the needs of their people were greater than the legal obligations to creditors".a
- In 1953, Germany's debt to the United States was reduced from $ S billion to $ 1 billion with the latter amount to be repaid in 35 years at 3 per cent interest .3

The regularity of debt problems led to the creation of new institutional mechanisms and in 1956, the Paris Club was formed to facilitate multilateral negotiations between sovereign debtors and official creditors of several countries at the same time. The Paris

• This is the revised version of a presentation made at the Vienna Roundtable. The views expressed are those of the author and do not necessarily reflect those of the Inter-American Development Bank.

Club took as its first case Argentina, whose current obligations were rescheduled for a 10-year period at market rates of interest.

Between 1956 and 1980, the Paris Club was only moderately active dealing with approximately two cases per year of official debt rescheduling.

After the 1973 oil crisis, private bank lending to sovereign borrowers became the predominant form of international credit transfer. Again there were the inevitable problems although these were relatively rare before 1980 - averaging only four cases of renegotiation per year between 1975 and I980.°

Since 1981, there has been a veritable epidemic of rescheduliogs - more than 50 with private creditors and more than 30 with official creditors (Paris Club). Of these more than half in each category occurred in 1983 alone. The pace remained at roughly the 1983 level through the first half of 1984.

In this paper I will not review the detailed financial and institutional arrangements of these recent renegotiations. This ground has been very well covered by recent publications of the ECLA, the IMF and OECD among others.& Rather I will try to draw some "lessons" from the recent experiences, focussing on why the debt crisis of the 1980s, in contrast to earlier ones, is proving to be so severe and so resistant to treatment. I will also try to trace some of the implications of the crisis for Latin America's future.

Lesson One - The Present Debt Crisis Is Structurally Different From Previous Ones

The current crisis is much larger in terms of the amounts o£ money involved, and more widespread than the earlier crises; there are also differences of a qualitative nature.
One of these is the particular difficulty involved in resolving debt problems between sovereign borrowers and private lenders.
When private borrowers have debt problems - these can be solved drastically but simply through bankruptcy of the debtor or by writing down the amount of indebtedness. In most cases, creditors can absorb the losses involved without destruction of their own financial integrity, since the exposure to individual private borrowers is a small part of the total portfolio. There are cases, such as the recent failure of Continental Illinois Bank, where creditors do get into problems as a result of a large number of bad loans - but these are rare.
When the debtor is a sovereign country, the bankruptcy option is not available, since national identity and obligations are presumed to continue even if governments change. This presumption has been honored even when there are revolutionary changes of regime. The Sandinista government which took power in Nicaragua in 1979, for example, recognized the debts of its predecessor.
If sovereign debts are owed to sovereign (i.e. official) creditors, then a solution is usually found through political negotiations. The sovereign lender can choose to enforce its rights by military means or can compromise, bearing in mind the debtors' ability to pay. Costs of the compromise are then passed on in one form or another to tax payers. During the 20th century, as mentioned earlier, the British, French and German governments, all obtained debt relief as a result of political negotiation.
Where the debtor is a sovereign nation and the creditors are private banks, however, we have a peculiar hybrid for which there is no obvious remedy. The sovereign debtor cannot declare bankruptcy; neither will private banks accept a write-down of sovereign debt. Private banks are largely intermediaries, who, unlikee governments, cannot pass on their losses to the public at large. Thus, if "problem loans" are large, relative to the banks' capital and reserves, as is the case of some banks who have considerable exposure with the major sovereign debtors, these debts cannot be written off without severely damaging the banks' financial integrity.
It is less clear why banks have so far refused to write-off debts of small, poor nations where the losses would be no more significant than those accepted for "bad" private loans. This attitude may be due to the practice of "syndicating" sovereign loans, which by creating what is in effect a "creditors cartel" commits all lenders to the same stance.
A second qualitative difference is the nature of the disturbance which has given rise to the crisis.
In the 1960s and 1970x, debt crises of the less developed countries (LDC) were generally caused by foreign exchange shortages due to disturbances in the real economy, Typical cases were: cyclical declines in commodity prices, or excessively expansionary fiscal and monetary policies in the debtor country.
These disturbances could be reversed in the short- to medium run. Commodity prices would recover as the economic cycle in the developed world moved from recession to boom. Bad macroeconomic policies could be corrected by adjustment programs. Since the context of the 1960s and 1970s was one of general world expansion, with world trade growing faster than the real rate of interest, difficulties in meeting debt obligations in such cases were taken care of by rescheduling principal payments at market rates. Thus, debtors got relief while creditors incurred no loss of earnings, merely a postponement of repayment of principal.
The crisis of the 1980s, however, is essentially due to a financial disturbance not to changes in the real economy. Its foundations were laid by the excessive overborrowing (and overlending) which took place after 1973 ass petrodollars were recycled to the non-oil exporting LDCs. Most of this debt was contracted at floating rates of interest which during the mid-1970s were extremely low in real terms (negative in some years) and, therefore, debt service ratios were tolerable.
In 1980-81, however, real interest rates in the USA rose to extremely high levels - to more than 7 per cent in real terms. This disturbance affected not only new borrowing but

all of the previous loans contracted at floating rates. Thus debt service obligations jumped dramatically causing a foreign exchange scarcity. The situation was further aggravated by a deterioration in commodity prices of most LDC exports which declined by 30 percentage points between 1977 and 1983.

The crisis of the 1980s is, therefore, unique in that difficulty with debt servicing was the major cause of the crisis rather than being the consequence of it. Treatment of the problem through contractionary adjustment by the LDCs has merely dealt with the symptoms of the crisis (i.e. foreign exchange scarcity and reduced import capacity) rather than its causes - high real rates of interest and low export prices. Indeed, as Fishlow points outs- to force debtor countries to run trade surpluses, in order to meet excessive interest payments is not a restoration of equilibrium but rather the creation of one disequilibrium to offset another. It is also unhealthy in that it leads, unavoidably, to a strengthening of protectionist tendencies in the major industrial countries.

The distressing aspect of the present scenario is that the strong recovery of the U.S. economy in 1983-84 has not produced a significant recovery in commodity prices. Nor is there any prospect of reduction in real interest rates in the near future. This combination of high rates of interest and stagnant export earnings for the majority of debtor LDCs means that ad hoc rescheduling of debt at market rates of interest gives no real relief. It only postpones the problem, pushing it forward and deeper.'

Lesson Two - Debt Reorganization In 1981-83 Has Not Been Successful

The OECD's 1983 Survey of External Debt of Developing Countries states: "The ultimate object of debt rescheduling is to restore creditworthiness and growth potential while safeguarding the financial interests of creditors".s

Thus successful debt reorganization involves three separate criteria: restoration of growth; restoration of creditworthiness; and protection of financial interests of creditors.

In terms of these criteria, debt reorganization in the postwar period prior to the 1980x, was almost invariably successful. With the exception of a few 'basket cases", those countries which renegotiated their debts in the 1960s and 1970s were able, after aa brief period of adjustment, to resume economic growth and to return to the private financial markets for new loans and credits. Since most reorganizations (official as well as private) consisted of refinancing principal at market rates of interest, there was also no sacrifice of the financial interests of creditor agencies.

Some commentators feel that there has been similar success in dealing with the current crisis. Bill Brock for example, argues that "we can view events with a sense of satisfaction - tragic consequences have been avoided"s Brock's comments are justified only as far as the third criterion - protection of the financial interests of creditors - is concerned. In this there has been considerable progress. In 1982 and 1983, there was fear, bordering on panic, that major defaults could occur leading to the ruin of several international banks and serious damage to the international financial system. The series of ad hoc refinancings arranged by the IMF and the international banks have averted the possibilities of involuntary defaults. In addition, the, debtor countries, particularly in Latin America, have shown that they have no intention of defaulting voluntarily- Moreover, many creditors took advantage of the renegotiations in 1983 to earn extraordinarily high profits and to build up reserves against future defaults. Thus creditors are now in a very secure position.

On the other hand, there has been little improvement in terms of economic growth. National income fell during 1981-83 for nearly every Latin American country, the first such decline in 50 years. In 1984, it appears that the decline has been halted. However, the losses in the 1981-83 period are so substantial that William Cline projects that "even with return to substantial growth in 1984-90, the 1980s as a whole seem likely to be a lost decade in terms of economic growth for the major debtor countries that have been in debt servicing difficulties". This performance is particularly
poor when compared with the fact that Latin America's growth averaged more than 5 per cent per year during the 1950-80 period.

We. should also note that Cline's scenario is relatively optimistic. Other studies, such as those, by Enders and Mattione, Fishlow and the 1DB, point out that a sustained economic recovery in Latin America is not inevitable, since continued high real rates of interest will cause Latin America to suffer a "perverse transfer of resources". This will make it

very difficult for this region to achieve the import levels required for growth.' 1
As far as creditworthiness is concerned, the picture is also grim. Latin America's total debt grew by more than $100 billion between 1980 and 1983. Debt service payment almost doubled in the same period. (See table below). Interest payments actually declined in 1983 due to a fall in U.S. interest rates. Unfortunately, this decline was only temporary and interest rates moved uo again in 1984.

Table 1

Growth of Latin American Debt between 1980-1983

		(Elllions of D.S. Collars)		
Debt Date	1980	1981	1982	1983
Debt	205	258	269	310
Net Interest and profits	19	29	37	34
Exports (goods)	91	97	89	88
Imports (goods)	92	98	79	56
Trade Balance	(1)	(1)	10	32
Debt/Exports (%)	225	266	325	352
Interest/Exports (%)	21	30	42	39

Source: ECLA-Preliminary Balance of the Latin American Economy in 1983.

Cline and others have pointed to the dramatic improvements in trade balances in Latin America as evidence of progress, but as Clne himself concedes - the principal source of adjustment "came on the side of reduced import values" rather than from export expansion. In fact, the table above shows that Latin American exports of goods actually declined by almost 10 per cent between 1981 and 1983.
It is, therefore, not surprising that Institutional Investor in March 1984 showed a decline in the creditworthiness rating of all LDC debtors with the exception of Mexico. The judgment of Institutional Investor is corroborated by the recent decision of Citibank to take out insurance against the possibility of default by 6 of its principal LDC debtors.
Thus, in terms of the three criteria: growth, creditworthiness and protection of creditors' interest, the recent reorganizations have been a success only in protecting creditors' interests. Those criteria which are most significant for the welfare of the debtors have not improved at all. This brings us to:

Lesson Three: The Debtor LDCs Have Borne An Unfair Share Of The Burden Of Adjustment To The Debt Crisis

This point needs to be emphasized. The Third World has borne the brunt of much criticism for its supposed irresponsibility and lack of realism in international financial affairs. Yet, as far as the debt crisis is concerned, it is the Third World that has acted with courage, a sense of responsibility and with foresight.
To take the latter point first, on a number of occasions - UNCTAD IV in Nairobi in 1976; the CIEC negotiations in Paris in 1976-77 and again in UNCTAD V in Manila in 1979 - Third World leaders warned of the dangers inherent in the excessive accumulation of debt and proposed that international attention should be focussed on measuress to deal with the situation.
The prescience of the Third World was not shared by the OECD countries, who saw little validity in the Third World concerns. Leaders of the industrial countries felt that private debt was not a potential problem but rather part of the solution to development. Moreover, the "market mechanism" which had generated the petrodollar recycling was expected to be self correcting, if ever the situation got out of hand. It is some consolation, if only a bitter one, to recognize that, at least on this occasion, the efforts of Third World leadership proved to be more sober, more realistic and more responsible than the views of those who relied on the "magic of the market place".
The sense of responsibility of the Third World is also demonstrated by the sacrifices made by the LDC debtors in order to meet their debt service obligations. As already

pointed out, in Latin America, income per capita has declined for the last three years, unemployment has increased and social welfare has declined. The sacrifices not only demonstrate the courage of Thud World political leadership but also the sophistication and tolerance of the masses who, with few exceptions (such as the Dominican Republic), have suffered the declines in living standards without resort to social upheaval.
The responsible behavior of the debtor nations is in stark contrast with the approach of the other principal protagonists in the debt drama.
The private banks have so far made no sacrifices in terms of accepting lower spreads or writing down the debts of the poorest debtor nations. In 1983, in fact, the banks took advantage of their position to increase spreads to extraordinary levels and to charge astounding "renegotiation fees".'a During 1984, the banks have attempted to improve their image. In September a new rescheduling agreement was reached between Mexico and the banks in which spreads were reduced and repayments spread over 15 years.
This agreement is a tremendous improvement over the exploitative "short leash" arrangements of 1983, but to suggest that it is a "reward" for Mexico's good performance is misleading. Under this agreement the banks will earn spreads of 1-1/8 per cent over LIBOR. This is twice the spread charged to Mexico in 1981, when it was running sizeable trade deficits.
Thus far, the governments of the creditor countries have also contributed little to the resolution of the debt crisis.
It is evident that the real solution to the debt crisis lies in the reduction of interest rates and restructuring of maturities. To illustrate this, if interest rates fell to their traditional level of 1 to 2 per cent in real term (6-7 per cent nominal), then the debt problem would literally disappear. Growth could resume, creditworthiness would be restored and banks could refinance without difficulty.
When interest rates rose dramatically in the early 1980s, it was expected that market forces would bring them back down in a short period of time. However, real interest rates have remained at extraordinarily high levels for nearly five years, and the prospects, as revealed by the financial markets, are for these rates to persist for the medium-term.
In August, the Chairman of the Federal Reserve Board, testifying before the U.S. Congress, stated that reduction of the budget deficit is the single most important action that the U.S. could take to ease the world debt crisis. But Volcker's words have had no impact, nor can they have in the near future. The reason is that, on the one hand, the impact of high interest rates on U.S. debtors is offset by U.S. tax legislation, while on the other hand, these high rates strengthen the dollar, attract foreign capital and imports to the USA, reducing U.S. domestic inflation," Of course, in the longer-run, the U.S. budget and trade deficits are unsustainable and dangerous.
It is worth mentioning that while the U.S. bears a special responsibility for the current situation, the other OECD nations have not been very helpful either. If interest rates cannot be brought down by market prices or by a change in U.S. fiscal policy, then the only solution would be to increase the flow of resources to LDCs from the multinational public agencies who are able to lend at long term and fixed rates which are lower than current "floating" market rates.
This is not happening. On the contrary, the OECD creditor nations are all suffering from "aid fatigue" and are unwilling to increase the resources of the multilateral public agencies - IMF, World Bank/IDA and the regional development banks. These institutions, therefore, find themselves restricted in their ability to respond to the needs of the debtor nations, precisely at a time when these needs are the greatest.

Implications for the Future

The unequal burden of sacrifice borne by the LDCs in the last 3 years has produced a sense of outrage in many countries. The sense of outrage is partly due to the moral issue: why should the debtors bear all the costs when, in fact, the responsibility for the crisis is not theirs alone but is shared by the creditors. It is also an issue of economics. An efficient solution would permit LDCs to improve their debt servicing capability through expansion of their productive base instead of requiring them to abandon growth in order to generate abnormal trade surpluses which are then transferred abroad to repay excessive interest charges.
At a series o£ meetings held during 1984: at Quito in January; at Cartagena in May; at

Santiago in August and at Mar del Plato in September, Latin Americans have stressed the inadequacies and injustices of the present process of debt renegotiation which has led even the moderate leaders to describe the situation as "a modem form of colonialism", which threatens the loss of Latin America's "economic and political freedom".10

But, despite their dissatisfaction, the Latin American debtor nations have not "rocked the boat". There has been no sign of the feared "debtors cartel In fact, so far, the only concerted action on the part of the Latin American debtors was to join together to help Argentina to meet its debt payments in March 1984. In other words Latin American debtors united to preserve the system not to undermine it.

The responsible behavior of Latin American leadership is not due to lack of courage to confront the system. It is the product of a conviction that the international trading and financial system served Latin America well as it pursued economic development in the postwar period, and that it is in Latin America's long-term interest that this system persist and be strengthened not weakened. They are, therefore, prepared to make substantial short-term sacrifices for what they believe will produce long-term benefits. The question is, will the sacrifices only be short-term? How soon will the international financial system return to healthy operation?

The answer is -we don't know. The key factor is the high level of interest rates and, as argued earlier, there are no indications that either market forces or deliberate policies will bring them down to normal levels in the near future. Consequently, Latin America faces a future in which it may be obliged to generate trade surpluses and transfer resources to the developed world, for a considerable time.

This prospect has serious implications. For 40 years Latin America's economic and social development has presumed a small but sustained net inflow of resources. If the resource transfer continues to be substantially negative, Latin America will have to revise its economic and political strategies. Either we will have to abandon the target of growth or we will have to devise policies which achieve growth and development through self-reliance."

Abandoning growth and development will be politically intolerable. Therefore, we are left with the second option which is very difficult. But it is not impossible. Latin America has surprised the world by its ability m meet the challenge of adjusting to the debt crisis. It has shown the capacity to generate the huge flow of resources needed to service its debt. It must now turn its energies to the challenge of devising strategies whereby this resource generation capability is mobilized for its own social and economic development.

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CHAPTER 7
The Rescheduling Experience o f Brazil
Carlos Geraldo Langoni

Brazil was one of the first countries directly affected by the abrupt reduction in external finance which followed the Mexican default. The dubious and undefined roles played by major Central Banks and governments of the industrialized countries have a great responsibility in the disorderly way by which the crisis has evolved. The basic contradiction was to try to adopt a "non-intervention" posture, when in fact the pure working of market forces was leading to a complete halt in loans to developing countries. The first reaction to the acute liquidity problems of some countries with large external debts was clearly procyclical and did much to magnify those difficulties. The best example was the frustrating IMF meeting in Toronto last year when, in the middle of the thunderstorm, the developed countries concluded that there was no need for any special action, either to reinforce the capital basis of multilateral institutions or to establish a liquidity window which could help Third World countries not yet directly involved in the exchange crisis. The concept of risk usually applied by commercial banks has quickly evolved from individual countries to regions, in an irrational attempt to correct in a few months the overlending of many years. The Central Banks knew, of course, that the attempt of each individual bank to reduce quickly its own exposure would be frustrated by the destabilizing effects of this action on the market as a whole. This process can come to an end either by unilateral action of the debtors - which means market disruption - or by some compulsory action by the Central Banks which could be understood as a way to internalize these "financial externalities".

Soon it was realized that there was a need for some compulsory action which was led by the IMF. The Fund began to play a new and innovative role whose objective was to assure, through direct pressure, the minimal inflow of external resources needed to finance the projected current account deficit. The banks themselves tried to organize their action around "steering" or "advisory" committees whose main purpose was to centralize the decision-making process, thus trying to iron out important strategic differences between large and small institutions as wet as among regional groups.

At the end, compulsory lending has substituted market forces through bilateral negotiations between private banks and LDC governments under the general surveillance of the IMF. Government credits have been restructured separately through the Paris Club. The Brazilian experience of the last two years allows us to point out the main features of the rescheduling process which are also generally common to other LDCs.

Rescheduling and the IMF

Up to now banks and governments consider an agreement with the IMF as a pre-condition for rescheduling. The exception seems to be the case of Venezuela. But even that country may end up with an agreement with the Fund.

The presence of the IMF as an "institutional coateral", and an important element to assure that fundamental disequilibria will be over, brings nevertheless problems, some of which are of the short-term nature and others of more long-term implications.

From a short-term optic the rigid link between performance under the IMF guidelines and disbursement of the banks' credits have generated what we could call the "quarterly syndrome". Every quarter there is a suspense whether countries will pass or fail in the Fund's test. Notice that legal clauses lead to an automatic suspension of disbursements not only of the Fund's resources but also of credits from the banks themselves whenever some of the performance criteria are not met. Therefore, any internal deviation will necessarily spill over the external sector resulting in a liquidity squeeze which may even lead to the acummulation of arrears. This, on the other hand, favours capital flight out of the country and helps to generate speculative pressures upon the exchanne rate which result in the deterioration of the trade balance. This high degree of uncertainty produces a new risk dimension that cannot be absorbed by conventional entrepreneurial action.

Consequently, there is a reduction in private domestic investment.
All these consequences were observed in the Brazilian case when, in the second quarter of 1982, it was necessary to ask a waiver with regard to the public sector borrowing criteria. It took roughly live months to renegotiate the nominal ceilings and at least ten months to redesign the external financial scheme.
But Brazil is not a singular case. Similar problems arose in Argentina, Chile, Peru, just to name a few examples. This reflects not only difficulties in the management of domestic policies but also over ambitious goals set by the Fund combined with the methodology of working with pre-fixed nominal targets in an environment of high (and variable) rates of inflation. Under these circumstances there is the need to project a monthly profile of inflation for a year in advance which, as the Brazilian experience has demonstrated, is a very perilous exercise. Implicit in the methodology used by the Fund is the idea that any deviation between current and expected inflation would have to be immediately compensated by further real adjustment.
In practice, and particularly when the size of the differential between projected and effective rates of inflation is large, the offseting movement on the real side is impossible within the required time constraint (one quarter) even when there is the political will to go ahead with the additional policy measures. This is particularly true when deviations do happen in the public deficit target, since in many countries there is a legal constraint to raise taxes within thq same fiscal year. Other measures such as wage policy may need Congressional approval. In short, the present arrangements do introduce an automatic link between internal and external disequilibria with a zero time-lag, thus maximizing uncertainty which, by itself, makes the whole adjustment process more difficult.
From a more fundamental viewpoint we must realize that we are not dealing any more with the transitory balance for payment disequilibria of the past which could be dealt fast through a stand by arrangement with the Fund that could last at most one or two years. Both external and internal imbalances of the LDCs are of structural nature and time will be an essential element to assure a sustainable correction. In particular, given the size of the overall stock of the external debt, many more years of rescheduling will be necessary, until we can alter the current picture. In this time perspective, what will be the geometric shape of present LDCs/ banks/IMF love-hate triangle? For sure the time-horizon for the correction of the structural sources of disequilibria goes beyond the actual three years of the Extended Fund Facility (EFF). This is also true from the final objectives of restoring voluntary lending in the financial markets. Therefore, from the viewpoint of industrialized countries and banks, they are probably counting on the permanent presence of the IMP in the LDCs. This, of course, will not he accepted by the LDCs unless there are profound changes in the rules of the game, particularly, with respect to the Fund's conditionalities, Thus, roughly within a year, when most of the current EFF arrangements will terminate, the continuity of the present arrangement of "rescheduling with the Fund" will be under strong pressure. The question is to know how the banks will react to a possible new stage of "rescheduling without surveillance" when, as in the past, they will have to rely more on their own evaluation of a country's performance rather than on the 1MF's formal green light.
One possible intermediate scenario, representing a sort of transition period, would be one in which the World Bank would, in a certain sense, replace the IMF as the institutional colateral in order to assure a minimal level of external finance. The expanded cofinance scheme in which the World Bank uses private banks' resources as a leverage to its own limited capital base takes the shape of an interesting mid-point between the present arrangement and the yet far-reaching ideal return to the market place. Of course, the key to the viability of this alternative scheme is the relative gain in terms of more flexible conditionalities that would stem from a greater role to be played by the World Bank uis-a-vis the IMF.
In short, both the short-run and the long-run analyses point to the fact that the present arrangements cannot be interpreted as a final optimal solution, As it will emerge from other points commented below much more thought and action are needed.

Rescheduling Under Market Terms
Another important feature of the rescheduling exercise is to try to apply market terms to a non-market situation. This is true not only with regard to pricing but also in what concerns the present system of raising funds which can be described as "quasi-syndica-

tion".
In the past, borrowing in the market was done in a decentralized way- It was designed to assure both the roll-over of amortizations coming due and some new finance usually associated with an investment project. Spreads and fees would reflect the creditworth iness of the country - in other words, a risk perception influenced by the relative share of public/private borrowing, the size of the borrowing needs itself {which was a mirror of the general economic conditions of the country) and the existence of tax credits or tax rebates. In the end, under normal market conditions such as those which generally prevailed during the period 1968/I981, the aggregate gross borrowing done in this way was generally sufficient not only to cover the current account deficit but also to allow some accumulation of reserves.
At present there is a formal separation between "amortization" and "new money". In the Brazilian case they were called respectively projects I and II in the so-called phase I of the renegotiations and projects A and B under phase IL Refinancing of amortization was broadly accepted by the banks as inevitable since no one would expect the principal to be repaid immediately even under normal circumstances, not to mention the condition of a liquidity crisis.
The process was, of course, no longer voluntary: all banks with maturities coming due in 1983 were forced to automatically refinance these amounts under roughly the same terms which have prevailed in the period previous to the Mexican default- The only exception was the improvement of the grace period (from 2.5 years to 5 years) in phase II of the renegotiations. (Table I)
There are also two important characteristics in the treatment of amortization: every bank which has an exposure in the country is included in the scheme; second, once started, the process becomes automatic, and it cannot be interrupted by an unilateral decision from the banks. Therefore, this is the only area of external finance where the decision-making process is, in fact, in the hands of the borrowing countries.
One could argue that even in this case, the continuity of refinancing the principal is dependent on the successful! implementation of an IMF type adjustment programme. In practice, however, the process will go on even when there is the need to renegotiate the agreement with the IMF, since the decision to "suspend" the refinancing is not, in fact, within the sphere of the banks. The best example is the Brazilian experience of 1983 when there was the need to ask a "waiver" to the Fund so that disbursement of the EFF facility and new money from the banks was interrupted but the roll over of amortization kept flowing without any legal dispute from the banks. Of course, the banks' attitude can be explained not only by a passive understanding of an inevitable trend, but also because refinancing of the principal can be easily accomodated in their accounting books.
The change in the nature of the "hew money" facility was more fundamental. It was no longer linked to any minimum level of investment, as in the past, but became oriented almost exclusively by short run objectives of the banks: to assure the full repayment of interest and to bring the rates of increase of exposure substantially below the speed of capitalization, in order to quickly correct the overshooting of the past. New money became thus a sort of disguised "interest facility" which is again being raised by a compulsory process that tried to copy the voluntary syndication under normal market conditions.
A fundamental question which will be raised subsequently in this paper, is that the risk perception of the banks is not necessarily consistent with an optimal path of current account reduction from the. LDCs'viewpoint. As a result, there is a tendency to underestimate the new financial needs, which means tighter liquidity conditions and a relatively slow recomposition of reserves, both factors leading again to the maximization of uncertainty. Implicit in the bank strategy of minimizing future exposure is the idea of not lending money to raise reserves. According to this interpretation, gains in reserve should be solely the result of an improvement in the balance of-trade, eventually reinforced by exogenous inflows associated with the Fund's disbursement. As a matter of fact, in every negotiation, the banks will, in a certain way, try to discount the expected gain in reserves, in calculating the amounts to be lent. Consequently, the building up of reserves - which is critical to restore creditworthiness - will take longer than it would be desirable.
The Brazilian experience is a good point. The concern of the bankers with their overall exposure to Latin America led to a new money facility in 1983 of US$ 4,5 billion, which

clearly understated the true needs consistent with the current account targets of the country. The accumulation of arrears along 1983 was the concrete evidence of insufficient financing which inevitably led later on to an additional facility of US$ 3.0 billion negotiated together with the 1984 needs (estimated in US$ 3.5 billion). Thus, in the mean time, despite substantial progress in the external front (the current account deficit was cut by half) Brazil suffered a liquidity squeeze which had an important negative impact upon real investment and output.

Another point refers to the logistics of compulsorily raising new funds from a large number of banks with different views about the future trends of the IACs and, in many cases, about their own role in the international markets being furthermore affected by a diversity of internal regulatory constraints. As we should expect, the process is lengthy, time-consuming and full of uncertainties. There is always a question mark: whether all banks will in fact participate with their "fair share". By the way, the definition of a "fair share" becomes an open issue. It is not easy to reach a consensus with respect to what credits should be included in the measure of each bank's overall exposure as well as to the choice of an ideal date of reference. There are signs of growing difficulties to go on with this process which, domestically, feeds economic and political speculation.

The first syndication under this new scheme was a US$ 4.5 billion facility which was raised relatively quickly (two months) since there was the practical incentive of a near-crash situation. Furthermore, to minimize transaction costs it was limited to large and medium-size banks. The second transaction (US$ 6.5 billion) was much more complex to the extent that it tried to broaden up the number of participants, meeting strong resistance from regional banks. As time goes by the tendency is towards greater internal differences between larger and smaller banks, the latter having a strong incentive to try to get a free ride, not participating
in the new money facility. Even larger banks from regions like Europe and Asia, where internal regulations are more flexible, are seriously weighing the high costs for the financial system as a whole of the present system of quasi-syndication which requires a lot of arm-twisting upon smaller institutions. The system could be defend ed as an emergency strategy to deal with the first wave of the crisis, but certainly cannot be considered as a permanent remedy to be applied over time in a non-market context.

Again the key question is the need to minimize uncertainty and to reduce transaction costs. Pricing of these facilities were set basically at the same levels which have prevailed under normal market conditions. Spreads over LIBOR were 2.125 in 1988 and 2.0 in 1984. Flat and commitment fees reproduced roughly the same terms that were applied when Brazil was very active in the market. For some countries like Mexico, spreads after rescheduling were even higher than before. Therefore, in the first two years the costs of servicing the debt were not an integral part of the negotiations. This reflects the extreme concern that the banks have in not making explicit the true differential that do exist between market and book values of their credits. Of course, after a default, it is very difficult to attribute any logical meaning to the idea that spreads should reflect risks. Either the risks are so high that lending would stop completely (an infinite spread in a pure market solution) or it would have to reflect a complete new set of circumstances, since the economy as a whole is also being restructured. In this latter case, what matters are expected risks which cannot be explained anymore solely by past behaviour. Until we have a new set of equilibrium conditions both to the economy and to the financial system, spreads should reflect more transaction costs rather than an arbitrary evaluation of risks. The counterpart will be a substantial decline in the profitability of the banks as an inevitable consequence of needed adjustment within the financial system. Insisting on pricing artificially the rescheduling of loans, as if we were under normal market conditions, has been one of the most regrettable aspects of the current debt negotiations. This is not even the common banking practice when applied domestically at the micro-level. It does, however, summarize the gravity of the present situation: on the one hand, it shows upto now how limited has been the effective bargaining power of the debtor countries; on the other hand, it also implicitly demonstrates how sensitive are the overall earnings of the financial system to a change in the rentability of their assets in LDCs. Upto now, the banks are succeeding in postponing the internalization of potential losses still hoping that, in the meantime, the debtor countries' adjustment and better world conditions will allow the full servicing of the debt under roughly the same usual market conditions. This is not a realistic viewpoint. Even with a relatively favorable world

scenario and sizeable reductions in current account deficits, the Latin American countries will still end up within a few years with extremely high debt service ratios. Sustainable adjustment will require structural changes such as export diversification and import substitution that requires time. Furthermore, social and political constraints will make the continuity of the present system of adjustment with recession extremely difficult over a longer period of time.

'therefore, the terms of rescheduling must be changed, and pricing will be the key parameter that will have to be raised at the negotiation table. The problems, of course, beyond that fraction of interest costs represented by the banks' margin. Working with con- ventional basic rates such as six month LIBOR and prime, does introduce an extreme variability in the country's external cash flow which cannot be adequately dealt with by an offsetting domestic action. The combination of a large stock of debt with unusually high real rates of interest has transformed interest payments as the most critical element in the external accounts of most countries. Thus, under the present circumstances, unless we fix both quantity and prices it is not possible even within a year's time to talk about "sustainable current account finance" which, by the way, is one of the primary objectives of the Fund's exercise.

Short-Term Lines

Short-term lines revealed themselves as a piece with multiple shapes thus making it difficult to find right away an appropriate place for these in the debt puzzle.

In the Brazilian case they have two different dimensions: trade related and interbank lines. Since the late sixties, when the process of integration between the domestic and the international financial market began, the Brazilian authorities were very cautious with respect to the external debt profile. Minimum maturities were legally imposed in order to take advantage of the best possibilities for longer-term finance, given the liquidity conditions prevailing in the market. Since most of the external resources were geared towards fixed capital, there was the concern of trying to reconcile the expected maturity of the investment projects with the maturity of the resources. At the time of the Mexican crisis, for example, minimum maturities were set at g years, with 2.5 years of grace. Brazil, therefore, in contrast with many other countries, did not choose to shorten maturities in order to reduce spreads. Neither was too liberal as to allow - like Argentina or Chile - a complete free movement of financial capital without any maturity constraint which, as we have seen, becomes a destabilizing factor whenever there is a sharp swing in exchange rate expectations. It is worthwhile to remember that the trigger mechanism for the Mexican default was precisely the piling up of short-term debt which was increasingly used as a means to finance a growing current account deficit.

In the case of Brazil, short-term currency loans were never used to finance the current account deficit while the financial market was still functioning only after the virtual closing down o£ the markets, the emergency bridging loan operations of short-term nature were negotiated with private banks, (US$ 2.4 billion), BIS (US$ 1.4 billion) and the U.S. Department of Treasury (US$ 1.8 billion). Hence, the growth of short-term debt, in the Brazilian case, was not the result of a deliberate strategy to finance the balance-of payment but the natural outcome of both the expansion of trade and the outside projection of our domestic financial system.

The changing structure of our exports with a growing share of manufactured products (which in 1983 reached US$ 11.8 billion or roughly 50% of total exports) necessarily led to an increasing demand for short-term trade lines. At the same time, on the import side, a growing ail bill, particularly in the period 1978-1981, also made inevitable a more intensive use of short-term finance which were readily available in the market. The relative size of the overall trade related lines reached US$ 9.3 billion at the end of 1982, which can be compared with a medium- and long-term debt of US$ 70.2 billion. As we can see, the numbers were reasonable, given the overall size of the Brazilian external trade.

Nevertheless, they caused difficulties; first, by definition, this was unregistered debt, and the aggregate numbers were only known after the crisis. Second, these were uncommitted and self-liquidating lines, therefore the vulnerability of the country was very great. Even marginal cuts in these lines would have a more than proportional impact upon external liquidity, since it introduces an unfavourable differential between the cash and accrual

concept of both exports and imports. In the Brazilian case, this effect was particularly critical by the fact that roughly 60-70 percent of the overall trade lines were allocated to the finance of oil purchases. In fact, between August and the first quarter of 1983, Brazil lost between US$ 2-3 billion of trade related lines which had a devastating impact on its external liquidity. As it can be readily understood, these characteristics of trade lines had a tremendous influence in the decision of the Brazilian government of not calling for a formal moratorium. At the same time, the stabilization of these credits was one of the main objectives of the phase I of the renegotiations (project III). By mid-year trade lines were finally stabilized at around US$ 10 billion; at the same time, direct financing from oil suppliers was also arranged, taking advantage of the soft petroleum market. Both elements help to explain the quick improvement from the cash flow viewpoint of our trade balance in the second semester of 1983. Finally, in 1984, there was a formal consolidation of those trade lines which became committed lines up to one year. This is one area where there is a good possibility of a gradual restoration of voluntary lending, following up the expected expansion of trade in the LDC5.

Of completely different nature was the behaviour of interbank lines to Brazilian banks abroad. The internalization of the Brazilian financial system was also, in a certain way, an expected outcome following the development of the world dollar markets with the growth of money-centers' spread over the four continents.

The idea of having some of the major state and private Brazilian banks - already with significant capital bases - participating in these markets and directly competing for funds abroad looked like a natural trend. Furthermore, the selection of those banks was an attribution of the Central Banks of the different countries where they were located.

By July 1982, there were 16 Brazilian banks abroad with a total of 104 branches, and outstanding deposits of about US$ 10 billion. As we should expect,it was exactly in this system where the practical action of reducing exposure to Latin countries was implemented by the international banks with greater efficiency. Traditionally, interbank lines were considered "residual funds", and thus they are uncommitted resources which may or may not be renewed at the time of maturity. Under normal market circumstances, maturities vary from one day upto one year, with the median around six months. Any change in expectations leads to a compression in the timespan of liabilities with a dangerous concentration upon overnight operations. With the Mexican shock, there was almost simultaneously a net leakage, an increase in the cost of funds and a concentration upon overnight operations. In the four months immediately after the Mexican crisis, Brazil lost about US$ 4 billion in interbank deposits. Of course, it is impossible to reduce assets at the same speed. This was particularly true in the case of some of the major state banks whose activities were very much geared towards long term financing. Among private banks, there was more flexibility, since a greater proportion of their assets was represented by trade financing.

The problem became still more serious because of the extreme concentration of these banks' operations in Latin America. So, at the same time that they were losing deposits a significant proportion of their assets was becoming illiquid and non-performing.

This was a completely new situation in which there was a direct relationship between the behaviour of one country's balance-of payments and the fate of their financial system. The reverse was also true: if one of the Brazilian banks collapsed, it would impair the chances for keeping the minimal required inflow of external resources into the country. Thus, the need to keep the Brazilian banks afloat in the middle of the thunderstorm has transformed the leakage in the interbank market into a de facto leakage in the external accounts themselves. During the last months of 1982 we were in fact living in a Kafkanian world where short-tern emergency loans painfully negotiated with the larger banks and multilateral institutions were being used not to improve the country's liquidity but instead had to be diverted to support the Brazilian banks abroad.

The behaviour of the international banks did not change significantly even with the formal proposal of debt renegotiation and the announcement of an agreement with the IMF by the end of 1982. As a matter of fact, for some small players who were nevertheless important, the prospective rescheduling led, in fact, to an acceleration in cutting short-term credits in order to compensate for some expected increase in long-term finance.

It is also clear that the drain would not stop without an active role of major Central Banks. The lack of coordination, the excessive concern with formal roles "of non-

intervention" which were not designed for an emergency situation like this one, conflicting regional views, all these have delayed the action to stop the process before it was too late. Just to give a curious example, some Central Banks and even multilateral institutions which happened to have deposits with Brazilian banks, were also trying to reduce their exposure. This dramatically illustrates how, during a crisis situation, there is a wider gap between collective and individual interests.

In the Brazilian case, the situation was particularly complex, not only due to the size of the external branches themselves but also due to a political decision of not nationalizing the banking system. This, of course, limited the possibilities for an unilateral freeze of deposits because of the risk of local legal retaliations. Therefore, the so-called project IV had an almost impossible task: to try, through direct pressure of a few major banks and some Central Banks, to revert the expectations of about 700 banks distributed alt over the world. The process was extremely difficult and risky since, despite all efforts, there was not an automatic the markets, the emergency bridging loan operations of short-term nature were negotiated with private banks, (US$ 2.4 billion), BIS (US$ 1.4 billion) and the U.S. Department of Treasury (US$ 1.8 billion). Hence, the growth of short-term debt, in the Brazilian case, was not the result of a deliberate strategy to finance the balance-of payment but the natural outcome of both the expansion of trade and the outside projection of our domestic financial system.

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rediscount window at any major Central Banks where it would be possible to close a liquidity gap for a short period of time. There is a sharp contrast between the amounts involved in the marginal rediscount needs of the whole Brazilian system abroad and the recent rescue operation for the Continental Illinois of the United States.

The collapse was avoided only by the establishment of a "safety net" where the major money-market banks contribute the needed residual amount at the end of each day. The system was precarious since this overnight roll-over was completely transparent, feeding uncertainty back into the market and thus making it impossible to restore the previous level of deposits. As we expected, the new equilibrium position of the Brazilian banks abroad was set at a much lower level than the pre-crisis position. By mid-1983, deposits were roughly stabilized at around USS 6 billion. In the meantime, there was a substantial reduction in the number of players with the small, regional institutions already completely out of the picture. The banks that were left had such a weight in the money markets that they could not afford to stay out. By that time there was finally an agreement to freeze the remaining interbank lines for one year which was formalized

later on.
The debt crisis has thus demolished another banking myth: interbank deposits to the extent that they are funding long-term assets, cannot any longer be looked as an aleatory residual. Otherwise, we will set in motion destabilizing forces which can easily lead to a collapse of the financial system. The Brazilian experience helped to point out the sort of knife-edge equilibrium that prevails today in the worldwide integrated financial network. In contrast with the past, the modern banking crisis will not take the form of depositors lining up outside the banks cashier. This, in principle, could be handled by firm action of a local Central Bank. It will probably start in a less noisy way but will develop with greater speed; its origins will be in the brokers' dealing rooms spread all over the world where modem communication allows a faster convergence of expectations. How to deal with this situation is another challenge that will require institutional innovation and much better degree of coordination among major Central Banks.

The Outcome: Net Transfer of. Resources

A basic question is what has been the result of the rescheduling exercise up to now.
First, one could say that the stability of the international financial system was preserved with a minimum degree of official intervention. As we observed, there was a tot of frequently disconnected moral persuasion but - excepting some extremely short term bridging operations by the USA Treasury and the BIS (which were fully repaid within less than a year) - there was no permanent commitment of real resources from the industrialized countries. This, by the way, seems to be a deliberately strategic objective: to minimize the degree of formal involvement of developed countries' governments in the debt crisis. The reasoning behind is the transitory nature of the problem (a pure liquidity crisis) and the "overborrowing" view which suggests that the LDCs are solely responsible in choosing an unsound strategy of "development with indebtness".
As we have mentioned before, the insistency of keeping a non-intervention posture in a non-market situation has led to a series of distortions with important negative impact upon the behaviour of the debtor countries. It is hard to measure the allocative losses associated with the occurrence of a new dimension of uncertainty which has been the trademark of the current rescheduling experience. On the other hand, up to now the banks have also benefited from the "buying time" approach. Assets to the major debtors are still performing through clever accounting gimmiks. Therefore, their nominal rentability was not fully affected by the true extent of the market losses. Furthermore, the data now available show clearly that the reduction of exposure was greater than one could realize by looking at individual countries and, particularly, at the highly publicized new money facilities.
American Express has estimated for nine countries (Argentina, Brazil, Chile, Ecuador, Mexico, Peru, Turkey, Venezuela, Yugoslavia) that the additional tern debt supplied by the banks after the crisis (US$ 9.2 billion) was practically offset by a sharp cut in both short term and stand-by lines (US$ 1.3 billion and US$ 7.9 billion respectively) with no net increase of exposure at all (Table 2). If we then add interest payments during the period we arrive at a net outflow of US$ 34 billion for this set of countries. This, by itself, reveals the profound swing in external finance that has happened right after the Mexican default. A similar picture is seen when looking at the balance-of-payment for the Latin countries as a whole in 19821983: there we also found a net transfer of resources to the tune of US$ 24 billion, which represents 19 percent of the region's exports.
The abrupt transformation of debtor countries into net exporters o£ capital is one of the most important features of the recent crisis which will have important long-terra implications for the development of the region. This is the result of the already mentioned sharp cut of credit lines to these countries combined with an acceleration of nominal (and real) rates of interest. Unfortunately, there is no clear trend for a natural reversal of these tendencies in a relatively short period of time.
Contrary to many initial projections, real rates o£ interest have remained unusually high for more than four years and no one knows when the United States will meet its own performance criteria on the public deficit question.
As to the behaviour of the international banks, their policy is clearly to assure a steady rate of increase in exposure well below the rate of capitalization which will also decline

given the smaller rates of profitability. Their policy will continue to be to lend the minimum sum needed to assure the full payment of interest without any serious concern about the development needs of a country. They assume that some still undefined official resources will fill out this gap of development funds.

In order to have a clear picture of this profound structural change in the financial markets, let us compare, in the case of Brazil, the current situation with another large external disequilibrium associated with the first oil shock of 1974-76 (Table 3).

As we can see, the external disequilibrium, measured in terms of the relationship between deficit in current account and GDP, was larger in 1974 (6.8 percent) than in 1982 (5.2 percent). However, since the financial markets were functioning with relative normality (in the second semester of 1974 and during 1975 there was a tighteningg in liquidity associated with the bankruptcy of the banks Herstalt in Germany and Franklin in the USA) and interest rates were falling in nominal terms (remaining relatively stable in real terms), the adjustment to the first oil shock followed a gradual path and it was associated with a significant net inflow of capital around US$ 4 billion per year. In sharp contrast, after 1982, the combination of the virtual closing down of the financial markets and high nominal (and real rates of interest) forced a much faster adjustment which was linked to a substantial net transfer of resources abroad. In 1984 this net outflow of capital may reach US$ 5.5 billion, which represents roughly half of the expected trade surplus.

As we should expect, over and above some important differences in the internal scene as well, this financial squeeze led inevitably to a pattern of "adjustment with recession", in contrast with just a slowdown in the path of growth which followed the first oil shock. The meaning of this net outflow of capital is different when we look at this from the viewpoint of short-run adjustmentt and development prospect.

From a pure adjustment viewpoint, the relevant constraint is the size of the current account deficit to be financed. In other words, the only sustainable trend is the one in which the total net inflow of resources (financial and risk capital) is, at least, equal and preferably slightly higher than the expected current account deficits. In the Brazilian case, this stage will be reached in 1984 when the net inflow of financial resources will be greater than the current account gap. In such circumstances, it is possible to have simultaneously an accumulation of reserves and a net outflow of resources. On the other hand, one could argue that - given the rigidity in external interest rates - this outflow is not only inevitable but even desirable since you must cut gross borrowing if you want to reduce the pace of your external indebtness.

If, however, your target is a non-negative net flow of resources (forgetting for a moment any supply limitations) you would have to accept a higher ratee of growth of total debt, although not necessarily of the net debt position. For example, in the Brazilian case, a zero net flow in 1989-84 would mean for the same trade performance a substantial gain in reserves.

The ideal path of short-run adjustment would be one in which the zero outflow constraint for a given trade balance target would be reached not by increasing gross borrowing but by interest rate flexibility: the picture would then change dramatically with a much quicker improvement in the current account, the simultaneous accumulation of reserves and deceleration in the expansion of total external debt. We could easily arrive at an extreme situation of a current account surplus with a positive net inflow of resources.

Of course, the real world is not as bright. The short-term adjustment is not a voluntary choice of countries in an ideal process of cost minimization. As a matter of fact, the adjustment is made compulsorily under given external conditions: availability of funds and interest rates. Under these circumstances, the trade balance is a residual, in the sense that you have to generate whatever trade surplus is necessary to cope with those real external constraints. The relative degree of efficiency in the process will be whether trade surpluses are being generated relatively more via export expansion or artificially via import compression. In the short- to medium-term this patter of adjustment will have a dominant effect over the growth possibilities of the country, much greater than the sharp cut in external savings associated with the shift in the direction of net financial flows.

Notice also that the stepwise approach followed by the banks in a non-market situation may lead to a perverse process in which a successful adjustment in one year (measured by greater than projected current account improvement and reserve accumulation) may reduce the incentive for additional finance. This only reflects the conflicting objectives

between banks and countries. From the viewpoint of the fnancial system adjustment means a continuous reduction in the rate of increase of exposure till the country reaches an ideal situation where no new finance is needed. From the country's viewpoint, possibly the best indication of a successful adjustment is a fast accumulation of reserves. It is clear that some exogenous element (probably IMP and developed countries' governments) will have to come into the picture in order to assure a more equitable outcome.
The change from being capital importers to capital exporters will have a significant implication for the long-term development possibilities of the LDCs. Even though external savings were never too significant in Brazil in average term (3.5 percent of GDP in 1970-80) it was extremely important from the marginal viewpoint. In Brazil a large proportion of external borrowing was directly associated with fixed capital investment. Only the external resources borrowed through Resolution 63 could be used for working capital purposes- Furthermore, we must take into account the indirect effects on the growth of the complementarily between financial capital, imported fixed capital and technological change. Even under the more orthodox view that, since money is fungible, the marginal rate of investment out of external resources cannot be too different from the own domestic funds, the projection of the current picture into the future will represent a permanent reduction between 0.5-1 percentage point in Brazil's steady rate of growth. Therefore a minimum level of external resources will have to be defined to take into account:
1) the economic contradictions of the present strategy of short run adjustment;
2) the political impossibility of justifying for a longer period the generation of trade surplus with slow accumulation of reserves and sizeable resource transfer abroad; and
3) the minimum required current account deficit and external capital absorption consistent with a sustainable level of economic development.

Future Rescheduling

The Brazilian experience of the last two years has been full of pain and misery. The shift from market borrowing to rescheduling was neither a smooth nor an efficient process. The overall aggregate results may, in a certain way, hide the distortions, not to mention the inequities of the present strategy. At the core is the myopia of the industrialized countries which insist on interpreting the current situation as a simple transitory liquidity crisis; associated with this view is the political decision of minimal external intervention and maximum internal adjustment - the result, in a non-market context, was the reduction of external financing more than could be justified even from the strict viewpoint of external imbalance.
This has been a period of prolonged uncertainty, which caused a lot of damage particularly to the private sector in the developing countries. The observed fall in real output and employment at unprecedented historical levels show by themselves the dramatic internal counterpart of this process.
More serious, however, is that we do not have yet a long-run strategy to deal with the debt problem that would fit the need to reach as soon as possible a new stage of "adjustment with growth". This strategy would have three basic objectives:
1. To reduce the actual degree of uncertainty;
2. To sustain overtime a minim..m level of external finance consistent with a long-term development perspective (and not exclusively from a short-term adjustment process);
3. To assure the stability of the financial system itself.
To minimize uncertainty implies the breaking up of the too rigid and automatic relationship that was established between internal adjustment and external finance. Of course, over time external and internal adjustment will tend to converge, but they do not (and generally will not) behave harmoniously quarter-by-quarter as it is now implicit in the current rescheduling agreements. The idea is then, that within a minimum timespan (say, at least a year), to count on the access to the previously agreed level of external finance independent of what may happen to some internal targets. After the period, new finance will then be analysed, taking into consideration the overall performance (both external and internal). The same flexibility could be introduced with respect to the IME's disbursement, one-quarter is too short a period of time to evaluate a country's performance or at least to trigger an automatic process of external liquidity squeeze.
Uncertainty will also be substantially reduced if we protect the country's cash flow from

the variability of external interest rates. This may be achieved by different methods, including an automatic clause for additional new money as an interest compensation. The more permanent solution, however, would be the partial interest capitalization which would, at the same time, eliminate the need for the time-consuming and inefficient system of "quasi-syndication". The amount of interest to be refinanced would be set on the basis of the current account target and the availability of funds from other sources. Regulatory constraints in most countries may be easily overcome with the formal assurance of full repayment at the agreed maturity, and using a basic shadow interest rate, thus still keeping a market reference (such as the long-term expected real rate of interest).
The extention of the rescheduling process to include pricing besides quantities would represent a fundamental change toward a more definitive approach. The impact of this change in current earnings upon different banks will vary from country to country and will have to be dealt with case by case and may require special rediscount schemes or fiscal relief. But, essentially, it will reflect the working of the adjustment process also within the international financial system. At the same time, since it will allow a more sustainable process of adjustment, it will minimize the risks of capital losses thus even allowing the release of some funds which would otherwise be frozen under legal provisions.
So we are already moving in the direction of the two other basic objectives. Even after an agreement about longer-term maturities, substantial changes in the pricing structure and a more automatic process of refinancing (both of amortizations and interest), there may still remain for some countries the need to reconcile the long-term demand for external resources for a steady growth with the private supply of funds in a non-market context.
First, it is essential to establish minimum rates o£ increase of the banks' exposure which should be geared not (inversely) to short run fluctuation in the debtor countries' reserves but, instead, to a more stable relationship, such as inflation rates and particularly the expected growth of their capital bases. Of course, in order to correct the overexposure over time it is necessary only to keep the rate of increase somehow below the capital basis; a sharp decline in reall terms is not needed.
Apart from this limit to the action of the private banks, there would be a need for other long-termm sources of resources either from multilateral institutions (stmctural investments) and/or from governments (trade related). Ideally, this new complementary scheme should be able to assure at a sustainable level of current account deficit,, a net positive inflow of external resources thus reverting the tendency observed in the years immediately following the financial crisis. Therefore, a political decision to increase the capital basis of existing institutions and to open up new channels for direct official flows will have to be made by the industrialized countries soon. Otherwise, it will be very difficult to get out of the present pattern of adjustment with recession or low growth. It seems reasonable to anticipate that even where successful adjustment does take place, restoration of voluntary lending will be extremely difficult to take place in the near future. Even if this "happy end" occurs, the nature of international private banking with respect to LDCs would have already changed, away from long-term finance to a greater specialization in trade activities.
Finally, there are two other important issues with a strong political content; first, what is the role that we are attributing to the IMF? Second, whether this new strategy will be the result of negotiations or confrontation.
The IMF position is sensitive to the financial community, to the industrialized countries, and to the LOCs. Upto now there is a close association between rescheduling and the Fund's adjustment programme. But the time-horizon for the debt problem goes well beyond the traditional time constraint of the Extended Fund Facility (EFF). The idea of a permanent Fund presence in the debtor countries is not politically viable at least under the present rules of con. ditionalities. So the transition toward a stage of rescheduling without the direct Fund surveillance will need to be discussed soon. This, by the way, may be a concrete obstacle to the present plans for mufti-annual negotiations; they do not make sense anyway, since the refinancing of amortization is already takenn for granted and new money needs must be defined on a yearly basis.
The second question as to how this new stage will be reached is highly speculative. What we can say is that despite a deliberate action by banks and industrialized countries the very evolution of the crisis is increasing the relative bargaining power of the debtor countries- First, in most countries a significant improvement in the external accounts has

occured which has allowed some - although modest - improvement in their liquidity position. Second, the overreaction of the banks has, on the one hand, slowed the pace of the reconstitution of reserves, and, on the other hand, has also diminished its relative importance as a source of external finance, furthermore, the formal transformation of short-term credits (trade and interbank lines) into medium-term committed facilities has eliminated one of the most vulnerable areas for some LUCs; finally, the swing from capital importer to net capital expoiter means that the question of repaying the debt became more than ever a decision about the use of domestic resource. Third, while the harshness of the times has gradually led to a great convergence of objectives among debtor countries, among the banks the incentive for cohesion has diminished with the overcoming of the near-crash situation of the last months of 1952. Apart from the differences on their debt structure, the Latin countries, for example, are united by the high U.S. interest rates. In contrast, the banks are more than ever divided on how to deal with the impact of unpredictable movements in the external interest rates. Furthermore, the Continental Illinois accident and the market reaction to the Argentina near-default has shown clearly that the banking system is vulnerable to a radical turnaround in the debt question.

Notice that the greater reliance upon official resources will make the debt question more and more a political issue. The Latin countries already understoodd that a coordinated action around common points is essential to force a change in the terms of reference. The world conditions will, in a greater degree, dictate whether the new stage of rescheduling - probably along the general lines described before - will be reached through a consensus between debtors and creditors or by unilateral action of the debtors.. If the expected slowdown in the economic activity of the OECD countries over the next years - mainly due to an accomodation of the American economy - is not anticipated by a substantial decline in the U.S, interest rate (which would mean a stronger action upon the public deficit in the United States), then there will exist all the conditions for a more radical movement on the part of the Latin countries. It is interesting to realize that with the virtual disappearance of the Latin and African inter-regional markets, the new-born trade surpluses are more and more dependent on the behaviour of the American and European economies. In this aspect a country like Brazil is more vulnerable on the trade side now than in the recent past when market diversification was greater.

In short, the. United States will have two basic alternatives in the coming months: either it is able to make a successful internal adjustment drastically changing people's expectations with respect to the future behaviour of its public deficit, or it will be forced to accept some non-traditional scheme to deal with the external debt question. This will necessarily imply a greater commitment of public resources. Let us hope that we have learned the lessons of 1982 and this time we will be smart enough as to anticipate the trends efficiently before a new wave of financial crisis is upon us.

Table 1

Brazil: Rescheduling Experience

	Phase I (December 1982)	Phase II (July-December 1983)
AMORTIZATION		
055	4.1 Mlllon	USS 535 MllIOn
Maturity	5.0 van	years
nrapPined	2.5 ys.n	vein
IntMait Rat! Ubot	2.125% par annum	
Prima	1.V5%pr annum	

Flat FM		1.50	
COmn$tma,tFa*		0.50	
NEW MONEY	US$	4.4 bllllon	U5S 6,5 biIOOn
Miturlty		5.0 van	9.0 years
Grit, Pirlod		2.5 Yaan	5.0 yiin
Iptbraal Rata Llbor		2.125% per annum	
Prim.		1.57$% per annum	
Flat Fp		1.50	
QommlimentFO		0.50	

Table 2
Brazilian External Debt

		(billions of U.S. dollars)	
Total	1982	1983	1984
Registered	83.2	91.9	100.8
Non	70.2	83.4	92.8
Registered	13.1	8.4	7.9

Source: Central Bank.

Table 3

A Comparison of Two External Shocks

Trade Balance	Current Account		Net lnflow Financial	Interest Payment U58 billion	Net Flow USS billion
US$ billion	USabillion	%COP	RewAr CaI USS Billion		

1974	-4.7		6.8	5.3	-0.6	4.7
1975	-3.5	6.7	5.4	5.3		3.8
1976		-6.0	4.0	5.9	-1.8	4.1
1882	8.0	-14.7	5.2	5.2	-11.3	-.1
1983	6.3		3.0	7.2		
1954'	12.0	-4.0	2.0	6.5	-12.0	-5.5

etlmated.
a) Net inflow of flfinclal resources equals currency loans plus financing and suppliers'
fees ION amortIIatibns and direct investment;
b) 1984 numbers are estimated, under the hypothesis that tM full U53 2.5 billion of
Government suppliers' loans will be in fact disbursed which IB practically Impossible.
c) I[does not include IMFresources.

CHAPTER 8

Recent Fund Role in External Debt Management

Azizali F. Mohammed

The purpose of this paper is to explain the Fund's role in relation to the debt problems of its member countries. This rote has changed recently, reflecting a change in the characteristics of the debtors' problems. The paper is largely concerned with the period since the middle of 1982.' In the preceding decade, most debt problems fell into one of two broad categories of cases: (a) low income countries largely dependent on officially financed or insured credits, and (b) middle-income countries that borrowed mainly from private and partly from official sources. In both categories, debt problems were perceived as individual occurrences, without wider implications.

For the first category, a well established set of procedures for redressment through the Paris Club framework has existed. These were not strictly codified arrangements, because creditor governments never did treat debt relief operations as anything but ex- ceptional events, undertakenn att the expressed request of an individual debtor government, in the face of accumulating payments arrears and an evident inability to maintain debt service .2 In such
cases, before agreeing to modify the terms by stretching out maturities of principal and interest, creditor governments expected the debtor country to have negotiated a stabilization program supported by the Fund through a stand-by arrangement in the upper credit tranches (without exception since 1977). Fund staff at Paris Club meetings was relied upon to furnish an objective assessment of recent economic performance, the main elements of a current adjustment program with the Fund, and the debtor's balance-of payments prospects and external debt outlook.

The second category of cases related mainly to middle-income countries that ran into difficulties for reasons of domestic policy weakness or unanticipated exogenous developments. Here solutions appeared to proceed in two steps. As a first step, private creditors, mostly commercial banks, were approached by the debtor government, especially when arrears on bank debt service payments appear-ed earlier than on official obligations. However, the banks quickly came to realize that in negotiating with a sovereign borrower in this situation it was not easy to work out conditions for economic policy that would give them sufficient assurance that policy changes adequate to prevent a recurrence would be implemented. It was, therefore, natural that in most of the bank debt renegotiations conducted in the 1975-78 period, the banks urged the debtor nuntries to undertake an upper credit tranche program supported by the Fund; in the case of five of the six countries negotiating with the banks during that period, a stand-by or extended arrangement was in effect when the banks signed the final agreement.

The banks also found that in the highly competitive environment in which they operated, it was difficult to reach common groundd on the financial terns and conditions of debt relief packages. With 200 or 300 banks from a number of countries involved, the need for "fair treatment" required lead banks to undertake a massive and often time-consuming effort to obtain cooperation from all the creditor banks; this was particularly important given the existence of "cross default" clauses in most agreements which would have created a chain reaction effect if some banks declared a debtor country in default.° Moreover, the anxiety of banks to ensure that their claims would be treated no less favorably• than the claims of other creditors often led to an insistence that the debtor government approach its official creditors through a Paris Club framework, if it had not already done so. Thus, four of the six countries in the 1975-78 period concluded multilateral official debt restructuring., and three of these came into effect before agreement was reached with the banks. When an official restructuring took place, the Fund's role reverted to that, described in the first category of cases. Of course, when the country was not a Fund member (Poland), the
banks had no choice but to develop coordinating mechanisms (such as steering committees) to renegotiate thee debt and to establish monitoring arrangements.
The Polish debt crisis moved the problem into its next stage, in which "contagion effects" came into play. The commercial basks suddenly developed an intensified perception of risk in lending to the East European countries as a group, thus affecting Romania and Yugoslavia, which were Fund members, and also Hungary, which became a member in 1982. When the countries' concerned turnedd to the Fund for support in this situation, the Fund was able
to provide assurance to the banks, by entering into a stand-by arrangement with the country, that appropriate policies were being adopted. Once an arrangement with the Fund was in place, the banks were willing to proceed with new credits as well as refinancing maturing debt.
Until this stage, the Fund's attitude was generally to try and help the debtor country devise a program that gave assurance that it could resolve its balance-of-payments difficulties in a medium-term framework. In some instances, the Fund staff did seek `indications of the likely magnitudes involved in a bank debt restructuring and also indicated to the banks the level of bank financing that it considered crucial to the success of a reasonable adjustment effort .
Starting with Mexico, followed by Argentina and Brazil, a perception developed that these countries' reliance upon commercial flows was so great that there was distinct risk of program failure unless the Fund could develop the means of assuring itself that the financial assumptions on which the program was based were secured by explicit prior commitments from the banks to cover their share of the ex ante financing requirements of the program supported by the Fund.
It was the need to obtain agreement on the provision of additional bank and official loans before approval of a Fund arrangement that altered the role of the Fund in relation to commercial banks in the management of the debt problem. For, in addition to its certification function, the Fund developed a catalytic rote as mobilizes of funds from other lenders. This departure arose from several considerations. As noted earlier, the Mexican reliance upon bank financing was so large and assistance that could be furnished by the Fund so small relative to the need that it was essential for the commercial banks not only to maintain their exposure but also to be prepared to enlarge it through the provision of additional financing. It was recognized that without such support, the compression of the economy, rendered unavoidable by lack of adequate exceptional finance, might well make the situation unmanageable and render ineffective the Fund's own financial contribution.
Second, it was important to keep all elements of the banking industry involved. The big money market banks understood that their stakes were so high that they could not afford to pull them out without greatly reducing the quality of their own assets. The problem was to ensure that hundreds of other banks, especially the
regional and smaller banks in the United States, would stay in the picture. If they did not, the major banks would be placed in the impossible position of having to explain (to shareholders, if not to depositors) why they were getting in deeper into a country from which other banks were hastily extricating themselves. This was the issue of maintaining market discipline, i.e., preventing an uneven reduction in exposure by a large number of

different lenders by ensuring that there was no leakage through reductions in short-term trade finance or withdrawal of interbank deposits. There were also complex issues of intercreditor equity amongbanks with very different exposures, and operating in different regulatory environments, with varying accounting conventions, disclosure requirements and ng constraints. These differences required formulae to be devised, in cooperation with the supervisory authorities, for allocation of net increase in exposure among the many banks, from a number of national banking systems.

Finally, there was the imperative of speed in reaching decisions by tight deadlines set in a credible way. A series of highly complicated and closely articulated relationships had to be managed among a very large number of players - in the case of Mexico, over 500 banks, their supervisory authorities in more than a dozen countries, governments of creditor countries, the BIS, the World Bank, and, of course, Mexico. The Fund found itself at the center of this web of relationships as it was later when similar arrangements were put in place for Brazil, Chile, Yugoslavia, and, Peru among others.

In each case, an agreement with the Fund became the basis bilizing much larger sums by way of restructuring and new financing. This was only natural since the adjustment effort mounted by the debtor country was the prime factor in giving assurance to its creditors that corrective action was being undertaken, that it had the support of the international community through the Fund, and that its progress would be carefully monitored. The task had to bo tackled country-by-country not only because of the obvious fact grang 'that the Fund could operate only through a stand-by or extended ement with each of its debtor member states. The fundamental meet on the balance between adjustment and financing had to made in each case, depending upon the initial conditions preva il- big at. the time of the debtor country's approach to the Fund, the lgvel of its foreign exchange reserves and its accumulation of pay-meats arrears, the proportions of debt owed to different creditors (multinational institutions, governments, private creditors), the types of claims involved (bank and export credits guaranteed by public authorities in the creditor country, unguaranteed trade and financial credits; floating rate notes, bonds etc.), the different types of borrowers (government, public enterprises, private sector), the number of banks involved, their size and national affiliations, and so forth. Special problems arose in respect of the interbank market in the case of the two largest debtors. Branches or affiliates of their banks located in the main financial centers, especially New York and London, had borrowed substantial sums at very short maturities and re-lent them longer-term to their principals or to other borrowers in the home country. These interbank deposits presented thee most difficult problem of preventing leakage of existing exposure, let alone assuring a net increase in exposure. These differences in country situations often emerged in the course of managing the crisis and had to be resolved quickly and in a manner that protected the cohesion of the various interests engaged in the rescue effort

Various generalized solutions were proposed during this period, born of a conviction that the burden of debt servicing confronting a number of countries simply could not be managed in a world marked by deep recession, historically high interest rates, and sharp curtailment of commercial lending. These schemes failed, however, to make much headway, for several reasons. First, they proceeded from a perception about the global aggregates that was never true for the components.

The existence or absolute magnitude of countries' commercial borrowings was not in itself a reason for payments difficulties, nor was the type of economy concerned. Table l provides a breakdown of the debt figures at the end o£ 1983 for all developing countries, and Table 2 shows ratios of debt to GDP and exports and of debt service to exports, separately for principal and interest payments. In each grouping are countries unaffected by a debt problem. Among the oil-exporters that are OPEC members, there are two (Algeria and Indonesia) with about 45 percent of debt in this category with no particular problem of market access. The non-oil developing countries are divided into several categories. The first is net oil exporters that are not OPEC members: Egypt and Malaysia, accounting for about one fourth of the total debt of this subcategory, were not affected. Among the net oil-importers, about one half of the debt is owed by the major exportta so h of f a t land and foul countries in this group (Korea, Israel, And prltugal),accunting for roughly for roughly one third of the total debt of the group continue toborrow at very period. aecounfviggetitive terms throughout the pe, and c are three countries - China, group In the low-income category no nee _ accounting for ally, of the esid.ial grouP at

least three major borr ttowers confronted their problems earlier and are already on the mend (Turkey, Romania, and Hungary), and two (Colombia and Thailand) continued to have market access on competitive terms. Any attempt to apply a general solution would have meant that countries whose creditworthiness was unimpaired would face difficulties in the market place for which there was no warrant; a generalized approach would have created a problem rather than provided a solution for them.

A second factor militating against generalized solution was that most such solution would inflict large losses upon commercial banks and do so in a manner that would prevent a gradual process of pro-visioning and building up reserves; allowing write-offs over a period of time. Schemes to transfer bank claims on developing countries to intenational or national public intities would have involved either substantial public sevtor commitments or immediate and open losses for the banks. This would have risked breaking the nexus between commercial banks and their customers in the developing countries and destroyed relationships built up over many years, if not deces. The debtor countries not only relied upon the international banks for normal trade financing but expected to reactivate their access to markets for project and sectoral finance. Indeed, the promise of being able to attract new flow as edisting credits were repaid was at the heart of the umflagging commitment that most debtors displayed in their approach to the debt problem. Generalized solutions tended to share a mechanical quality and were focused on quantitative elements, such as net capital flow or net resource transfers, whereas the protagonists were more sensitive to the organic inter-relationships that underlay the financial magnitudes.

Athird flaw of most generalized from the governments of the that support would be forthcoming from the government was not conducive to such use of public funds. The many countries, there was a drive to cut back on budget deficits, and any solutions that impeded the attainment of this objective were unlikely to find favor with financial officials and legislators. An even greater problem lay in a widespread public perception that the commercial banks had lent in an imprudent way, and that public funds should not be employed to rescue large private institutions from the consequences of their own errors of judgement. Similarly, while developing countries experienced serious adverse external conditions, their payments difficulties resulted in part from inadequate domestic economic policies. There was also a feeling that many of the countries that were in difficulty were among the most advanced among the developing countries and that the application of public funds would skew the distribution of aid flows away from countries that were poorer, had little or no recourse to market borrowing from abroad, and stood perhaps in even greater need of external assistance for dealing with their official debts.

A final problem with some generalized solutions lay in the time that their implementation would require. In many instances, changes were necessary in national legislation or in the charters of international institutions whose amendment required high voting majorities and largee participation ratios to become effective. Yet in dealing with debt problems as they arose, time was of the essence and the constraints set by the need for urgent action meant that solutions had to be found within the bounds of existing legal and institutional arrangements.

With the passage of time, some evidence of the viability of the case-by-case approach has begun to accumulate. In the 18 months ending in mid-1984, the external adjustment that has taken place in the non-oil developing countries has been characterized as "dramatic", and while it is recognized that much of the adjustment involved sharp cuts in imports, many of the countries are "already experiencing a resumption of growth, with activity in some sectors accelerat ing sharply" .8

On the financing side, the Fund has disbursed some US$ 22 billion since the middle of 1982 in support of adjustment in 66 member countries, with another US$ 8 billion of commitments outstanding under 34 current programs. In addition, new financing has been mobilized along with debt rescheduling. In 1983, some 30 developing countries (including ii off the 25 largest boriowers) completed or were in the process of completing debt rescheduling agreements with official and commercial creditors. These agreements reduced the debt service payments of non-oil LUGS by US$ 23-24 billion in 1983 and by about the same amounts in 1984. As a rest their debt service ratios declined from a peak of 25 percent in 19 to 22.3 percent in 1983. This compares with 27.6 percent which would have applied in the absence of rescheduling. The maturi structure of debt has also been improving with the ratio of she

term debt declining to 25 percent in 1983 from about 30 percent exports of goods and services in 1982 and to an even lower ratio 1984. In 1983 US$ 13 billion of concerted bank lending was al arranged in conjunction with Fund-supported adjustment programs.

Despite these encouraging developments in the debt situati< and the recovery in the industrial world, there persists considerab pessimism over the manageability of the debt problem. One expla anon for this paradox is the existence of lags between actions take by debtor countries and the recognition of the positive results belt botaght about. A second source of concern has been the prospee oLa"hump° in countries' debt amortization in the next few year abort 2o percentage points in f interest 3rates hn the factor first half he 1984.- This disturbing development has generated another spate gmrafzed solutions for "capping" interest rates and for reducin ' . the burden of higher interest rates in other ways. There is no ques t1S that the development of interest rates poses a risk to the viabil ity;of the solutions that have been found. However, before giving much credence to the proposed solutions, two sets of factors mus ba.kept in view.

- At a more general level, there are three elements to be consider eel. First, the trough in imports of non-oil developing countries was reached n the fourth quarter of 1982 with imports from industrial countries falling by about 20 percent in U.S. dollar terms from early 1981 to late 1982. Thereafter, the financing packages put together in association with Fund programs were sufficient to stabilize the level of imports. Second, the exports of non-oil LDC5 began to re dSer from the fourth quarter of 1982 with the recovery in output inahe industrial countries. As a result, the exports of these countries q.; rat from some US$ 190 billion (at an annual rate) in that quarter to lS eUS$ 240 billion in the first quarter of 1984. This expansion of helped to bring about an improvement in the trade balance order of magnitude approaching us$ 70 billion (at an annual f,) in the trade balances of this group of countries. The room $ this created is expected to result in a resumption in the growth of imports, projected to rise in volume terms by about 6 percent in both 1984 and 1985 despite the increase in non-oil LDCs interest charges (net of interest earned) or about US$ 6 billion (at an annual rate), with the full effects not coming through until 1985. The third element to keep in mind is the import intensity of domestic output. While the relationship between the growth of imports and that of GDP has in the past been reasonably stable in the vicinity of unity, there is evidence that the relationship can depart significantly from its trend value in times of large external adjustment and that the reversion to trend following periods of such adjustment occurs only slowly.

At a more specific level, the effects of interest rate movements on dollar-denominated debt are sufficiently differentiated to require careful analysis of the varying situation of debtor countries. There is, first of all, a wide variation in the reliance of countries on floating rate credit. As noted earlier, most of the poorer countries in Africa and Asia have not been significant users of such credit, some because they chose not to. Second, the proportion of variable rate debt in total debt has varied, and a proxy for this might be the proportion of debt owed to banks in total debt of each of the major borrowers. Table 8 shows the ratios for selected countries identified as major borrowers for 1982. (Later data for debt owed to banks is available for 1983 from the Fund's new series and is shown in Table 4.) it is obvious that the reliance on bank debt has varied considerably. Third, the interest rate factor has been offset to a varying extent by improvements in export receipts, following the strong upswing in North America which has accompanied the hardening of interest rates. The offsetting benefits have been greatest for such countries as Mexico because of their proximity to the U.S, market, but the upswing has also helped countries farther away, such as Korea, which have a highly diversified productive base and possess the flexibility to adapt rapidly to the requirements of a booming North American market.

There is a recognition that imaginative solutions may still become necessary if interest rates continue to rise and commodity prices continue to weaken as they have since May 1984. However, there is an inclination to confine the search for such solutions to the banks sitting down with each debtor and working them out with some outside support from the supervisory authorities of the banks and also from the IMF and the World Bank.

A recent example of this general approach is the proposal advanced by the Managing Director of the Fund to consider a longer timeframe for bank rescheduling arrangements for countries that have made or are making substantial progress towards adjustment as a way of rewarding good performance, avoiding the necessity for repeated annual reschedulings, and restoring the conditiops needed for the return to market access, as well

as for rebuilding confidence in the system. He proposed such an approach for Mexico and expressed hope that other countries, such as Brazil, whose performance is improving steadily, could also qualify if their progress is sustained. The periods of consolidation, as well as of grace, would have to be long enough for these advantages to be obtained. The Managing Director also proposed that countries that are performing well should benefit from improved terms Such a longer-term arrangement is now under negotiation for Mexico. Successful completion of mild year restructurings would illustrate banks' readiness to adopt a forg4aYd-looking approach to debt restructuring, and would represent important step in preparing the way for countries' return to more gnosmal market access.A longer-term perspective is needed but not only on the fnanfstj- Y 4 side. Indeed, any financial re-arrangements must reflect a me1; :; ydluoa term view of the adjustment process being undertaken in the .-,;.°debtor countries. This element has always been central to the Fund's dtking on the debt problems, but in the last few years the Fund's I;aiweillance of countries' external debt management has been made ltore explicit and substantially strengthened in this regard. An !..:important element has been the inclusion of medium-term balance -tof-payments analyses in the Fund's consultations with individual member countries. In addition, a more explicit statement of this ' _approach iss evident in the adjustment scenarios developed in the World Economic Outlook exercises using varying assumptions regarding the external environment as well as the quality of the do~. »Nedtic adjustment effort. These scenarios are refined continuously
provide the framework for a medium term analysis of individual count debt situations in the Fund.

Table 1

External Debt of Developing Countrics Outstanding at End-1983 And Debt Service Payments in 1984

(Ellllons of OS dollars)

	Witnwmcgoarantee Total Official Financial medium debt	credton	Private crcaton Without Others	9uararo tae	Total 571 on tern, and long hhn debt	1984 Sa,vica intera ct pay-	Amor t- zaticji	Debt Total debt Service feM(91
1. 2. 3.	14+	(2)	(4)	(5)	(21+34+ (4)t(5)= (5) I	(0)	(9)	(10)

4. Oeveloplng ountrles	706.6	239,7	244.6	52.5	1t9.	655,8	130.7	71.9	5	107.2
5. A.Ow.xporlns	1018	19.8	40.5	9.7	0	80,9	20.1	7.2	-	342
6. B, 'knoll	685.5	219.9	204.1	42.8	10.9	47=9	110.6	64.7	73.8	73.0
developlngcountries	164.2	35.9	67.3	12.2	108,	138.5	25,7	20,4	28.7	42,8
Of whlcN	521.3	181.0	137,0	30.6	7	436.4	84,8	44.3	8	6.7
(1) Net oI*paten	271.7	44.0	83.6	2014	20.3	213.9	2.3	0	9.9	23.4
(2) Net gNmyorten	08.8	73.8	08	79	07.8	05.9	30.0	3.5	13.0	7.7
Of which:	167.4	63.2	44.5	7,4	55,9	1355	7L2	10.5		20.4
I) Male, exootten of	66.2	41.9	15.6	23.7	1.3	63.9	117	6.2		46.5
anubetmY	167.7	75.5	37.0		20,6	137.7	44.0	4,5		
(II) Low-	75.0	21.4	24,0		3.1	63.8		33.5		
lacomecountOm	556	328	3.1		18.0	43.9				
(111) Others	299.1	48.8	120.2		16,7	255.1				
Africa					62.4					
(eTCludin95w(hAfrica)										
Asia										
Europe										
Middle Eat										
WmlamHemisaIere										

= Exdudas d4Dt of agnt tO Xpw3M9 county Mran. Iraq, Kuwait. me Libyan Arab The Islam c Repugtc of JamTIdya, Oman, Qatar Saudi Arable, and me V nlted Arab Emlnta.

Solace; IMF,IbrtdEm;dm/cOut/oak - GanerwI&ney(AUyHl984).

Table 2

Developblg CounU ea: External Debt Outatalldlllg At End-i983 Relativ and 19 9 DPeand Exports

(

	Outstanding Debt End-1983		Debt Services Payments in 1984	
	%to GDP	% to exports	% of interest payments to exports	% amount ization to export
Developing countries	35.5	155.4	12.8	9.1
Oil exporters	5.2	20.0	1.3	1.5
Non-oil edvelopment countries	34.9	154.4	13.1	8.5
Of which				
Net oil-exporters	60.4	210.8	20.4	13.8
Net oil-importers	30.9	142.4	11.5	7.5
Of which				
Major exports of Manufactures	37.4	127.6	12.3	6.5
Low-income countries	15.3	154.8	5.4	6.6
Other	42.0	167.9	13.4	10.3
Africa (excluding south Africa)	54.6	220.7	11.3	13.6
Asia	21.3	83.1	5.1	4.8
Europe	34.4	127.2	10.0	11.4
Middle East	56.4	173.2	13.5	9.7
Western Hemisphere	45.3	300.0	32.1	12.5

1/ WEO (August 1984)estimates of GDP and exports for 1983.
2/ WEO (August 1984) projection of expots of good and services for 1984.

Table 3

External Debt and Debt to Banks of Selected Major Borrowers Among Developing Countries, Outstanding as at End-1982

(bmrons of is. aoiwa)

Mgor borrpwefa	Total debt (11	oem to banks (21	% of column 2 tocolumn 1 (m percent (3)
Algeria	19.5	7.6	56.2
Argentina	36.6	25.6	70.0
aazll	83.2	60.4	72.6
Chile	17.1	11.6	67.8
Colors la	10.3	63	61.1
Egypt	15.4	4.9	31.8
Hungary	6.7	6.7	100.0
India	19.8	2.2	11.1
Indonesia	16.4	9.9	53.8
nrael	14.9	6.6	44.3
Malaysia	7.7	6.6	85.7
Mexico	82.4	62.8	76.2
Morocco	0.0	3.8	42.2
Pakistan	9R	0.6	6.7
Peru	10.3	5.3	51.4
Thailand	8.5	4.9	57.6
Venezuela	31.8	27.4	86.1
Vugpslavla	16.0	9.8	62.2

Source: For total debt: World Bank Debt Tables, 1983(84 Edltlon and Supplements except for Latin American countries which are derived from Inter-American Development Bank Swiss. For bank aebR B.I.S., '?he Maturity Dinribution 07Int.rneticnat Bank LenWng".

Table 4

Selected Developing Countries Ranked By Debt to Banks, December 1988'

(billions of U5. dollars)

1.	Mexico	84.9	24.	TNlland	5.64
2.	Brazll2	6	25.	Greece	.
3.	Argentina	73.7	26.	Peru	5.58
4.	Korea	1	27.	ChIne,Peoples Rep. of	1
5.	Venezuela	24.0	28.	Morocco	4.2Z
6.	Phlllppines	7	29.	Iran, Islamic Rep.o17	4.1d
7.	Yugoslavia	23.4	30.	Ecuador8	4.0Z
B.	Indonesia	3	31.	Ivory Coast	3.77
9.	Egypt	21.2	32.	India	3.63
10.	Chile	1	33.	Syrian Arab Republlc6	2.3q
11.	South Africa	14.6	34.	Uruguay5	2.01
12.	Malaysia	5	35.	Costa Rica7	1
13.	Algerla3	14.5	36.	Pakistan	1.81
14.	Portugal	1	37.	BolivIa5	'
15.	United	Arab13.2	38.	TunI81a	1.76
16.	Emirates	5	39.	Sri Lanka	1.5
17.	Romanla4	11.9	40.	Jamaica	&
18.	Kuwait	6	41.	Sudan	1.57
19.	Turkeys	11.9	42.	Iraq	1.35
20.	Hungary	1	43.	Nlcaragua4	'
21.	Saudi Arabla2'S	10.6	44.	Cemer00n5	1.34
22.	Nigeria	1	45.	Zambia	1.28
23.	ColombIas	9.99	46.	Dominican Republic	1.27
	Isrtel5	9.58			.
		9.40			7.24
		9.01			1.23
		9.00			'
		8.94			1.12
		8.81			1.06
		8.62			1.04
		7.95			1.00
		7.75			
		6.32			
		5.67			

1/ Figures are the sum of cross-border Interbank accounts by residence of borrowing
bank and international bank credit to nonbanks by residence of borrower. As at the end
of December 1963 unless otherwise noted. Relates to countries with debt owed to banks
of at least U881 billion.

2/ Latest published data for crass-border Interbank (CBI) accounts an Fund estimates.

3/ Latest published data for CBI accounts as of and of September 1982.

4/ Latest published data for CBI accounts a of end of June 1983.

5/ Latest published data for CBI accounts a of end of September 1983.

6/ Latest published data for CBI accounts as of end of December 1982.

7/ Latest published data for CBI accounts.. of end of December 1961.

Source, international Monetary Fund, International Financial Statistia.

1/ For material covering the early period, see in particular the

following publications:
Nowzad, Bahrain, and Richard C. Williams,External Indebtedness of Developing Countries, Occasional Paper No. 8 (1981).
Rnn R and R C Williamc Rorone Mvlrdnearnl Rob Roefnrrh,,roan

with Official and Ban* Creditors, Occasional Paper No, 25 (1983).
International Monetary Fund, Annual Report of the Executive
Board for the Year Ended d AApl nnual 30 1979 PP' 60-61; Annual Report, 1980, p
andAnnualReport, 1982, Report, 1981,
-77
International Monet PP• 7ld E PP• 79_82;
1980, PP• 4142; Fwd• Worcon Outlook (WEO)
WEO 198 WEO 1981 (Occasional Paper 4), PP. 1
2 (Occasional Paper 9)r PP• 24-26; and WEO 1983 (Occasional Paper 21), pp. 23-26.
Also various speeches January a 9 Orectorofthe Fund especial
ly, IMF Survey
July 7, 3540, MF Sun,IMF Survey, November 951981, pp. 350
IMPSurvey , June 21, 1982 p. April 1 1982, PP• 97-102; and
P 177, 84-186.
P
/ In a ssepaC to category were debt relief operations undertaken as art of d onsortia to exchange. There was no debt r problem, countries with untied foreign relief provided to India, for as such, in the case of debt
a transfer problem inhering instance, under Consortium auspices but capital goods sector which m the fact that India had a so
the usual form ode it difficult for it absorbtaidtre'nd rm of project £mooting of foreign equipment
.
5/ Occasional Papers, p. 38.
4/ Ibid, pp, 34-35.
5/ However, in the negotiations with the banks, the Fund staff
participated in some meetings, including (with the knowledge the
debtor) meetings in which the debtor was not present. On occasion the Fund assumed a of for
authorities, in more active role, at the request of the debtor provided technical Lassistance to so s with the banks. The Fun
their discussions wi isome the countries in preparing statistics (ibid, p 38th the banks and helped with the compilation of
6/ Ibld, p. 38.
7/ For a detailed description of the various elements involved in
the Mexican operation, see Joseph Kraft, The Mexican Rescue (Group of Thirty, New York, 1984).
8/ IMP Survey, June 18, 1984, PP• 178-182.
9/ WEO 1984 (Occasional Paper 27), pp. 59-77.

CHAPTER 9

Debt and Development Crisis: The Case o f Small- and Medium-Size Debtors

Christine A. Bogdanowicz - Bindert

"Something must be done about the debt, [...1 it is like we are on a sinking ship running around patching holes one after the other. We go from one crisis to another. It is not only very annoying, it is also very costly". President Femando Belaunder

Since August 20, 1982, when Mexico declared bankruptcy, a lot has been written about the Third World debt crisis. Debt reschedulings have become front page news. Mexico's, Brazil's and Argentina's debt problems have suddenly become realities for the readers of the popular media. Books and articles have been devoted to the near-crash of 1982 and to Mexico's success story.

This paper addresses the issues faced by a different group of debtors, namely the medium- and small-size LDCs, which pose relatively little threat to the international financial systemm and have limited leverage in the political arena.

My experience in debt reschedulings goes back to the mid 1970s, when I was at the International Monetary Fund dealing first with Gabon, and later with Zaire. In 1980, I

joined the so called Troika' and was part of the team which advised the governments of Senegal and Costa Rica on their debt rescheduling options both with respect to official creditors (Paris Club) and commercial banks .3

Although most of my examples are drawn from my most recent experience - namely dealing with Costa Rica's cash flow problems - the issues faced by Costa Rica are similar to those faced by a number of small- and medium-size debtors such as Peru, Ecuador, Chile and Bolivia.

This paper is divided in three parts. In the first section I will briefly summarize Costa Rica's debt rescheduling experience and highlight a number of setbacks that Costa Rica incurred as a direct result of Mexico's 1982 debt settlement. The experience of Costa Rica illustrates the difficulties small debtors encounter when much bigger fish are in the same ocean. The second section summarizes some of the current issues these countries face, especially in lig of the recently announced multi-year rescheduling of Mexia public external debt. Finally, in section three, I propose a mode agenda relating to the as yet unaddressed problems of small- ar medium-size counnies.

The Experience of Costa Rica^

When the Troika was first approached by the then govemmen of Costa Rica, the government did not seek the Troika's advice or debt rescheduling as there was little awareness of how acute du foreign exchange cash flow situation was. Rather, we were initially consulted as to the possibility of rolling over Costa Rica's short-term commercial bank loans. Thus, we found at the outset that our first task was to attempt to determine how much debt the country had
accumulated, how much of that debt was short-term and to whom the debt was owed. Incredible as it may sound, it is not unusual for a sovereign borrower not to have a good overview of its total external debt. The next task was to determine how much foreign exchange was actually available for debt service. This information was crucial in determining the arguments which could be made to persuade creditors that a roll-over of short-term maturities was in their interest as well as in Costa Rica's. It is important to keep in mind that the banks are not charitable organizations nor are they development agencies Banks are in the business of making to and such is their responsibilit Pment Y uti-s-uis their shareholders make a profit Vis-à-vis their shareholders.

After a few meetings with government officials and policy. makers, it became clear that the government did not have a good handle on how much of its reserves were actually liquid the struc ture of its external debt and the amount which was falling due in the next 4 to 12 weeks. I would like to stress that such a situation is not peculiar to Costa Rica as we all know from accounts of similar difficulties in Argentina and Venezuela, to mention only a few of those countries that made headlines in 19$2.83.

Our first task was thus to assist the country in assessing the magnitude and characteristic of their problem. While we sought to diagnose the situation, we recommended that the of Costa Rica continue servicingits obli Government of cranking numbers we stablished that hothe After days and nights have the capability to pay the maturities falling w due and d did not that the foreign exchange situation was so precarious that the country could not even meet its current interest obligations. Contrary to news paper accounts at the time, the Troika did not recommend that the country stop servicing its debt. The fact was that the Central Bank had run out of money by the time we became involved. What we did recommend was that, in light of the lack of liquidity and the fact that the country could not even keep current on its interest obligations, the country stop all payments while it reassessed the situation and devised a meaningful strategy to cope with the crisis. The apparent alternative was to continue with small ad hoc payments to a few creditors, thereby granting them arbitrarily preferential treatment. The other alternative would have been to make minimal payments to all creditors, subject to foreign exchange availability.

The situation was further complicated by the fact that, as in most other debtor countries, few Costa Rican officials had handled a crisis of such magnitude before and the limited number of high level policymakers and technocrats experienced enough had to spread themselves thin to attend to the external liquidity crisis precisely at the same time when the domestic situation was unraveling, with capital flight booming and black market activities flourishing.

Generally the scencrio is like this: the minister of Finance and the governor of the Central Bank are in high demand; commercial bankers will be lining up in front of the ministry and the Central Bank or will be sending telexes and telephoning, pressuring the authorities to pay them back. The IMF team and the World Bank staff are calling on the same minister and governor to discuss the measures necessary to redress the situation. The minister, together with his colleagues in the Cabinet and at the Central Bank, has to attend to many fires, explain the situation to Congress and to the nation, and does not always have the support and the staff to help him cope with the increased pressure.

In the case of Costa Rica, the situation was made more difficult by a Government which was in the last year of its administration and was thus reluctant to introduce drastic austerity measures and be seen as yielding to foreign creditors and the IMF. Between August 1981 and May 1982, when a new Government presided by Luis Alberto Monge came to power, the domestic economic situation deteriorated markedly. Debt service obligations to official and commercial creditors were virtually suspended resulting in a massive accumulation of external arrears.

In May 1982, the Government of President Mange was sworn in. As part of the new Cabinet, the President created the post of "Special Advisor to the President on external debt matters" with rank of a minister. The new Government immediately embarked on a comprehensive plan to deal with the crisis. A drastic austerity program was introduced, negotiations with the International Monetary Fund resumed and a strategy to deal with foreign creditors was devised.

Given the massive accumulation of arrears - both of principal and interest - since the third quarter of 1981, and the high level of contractual debt obligations compared to the expected availability of foreign exchange, it was obvious that arrears were going to continue to accrue. However, in order to improve its relationship with creditors, Costa Rica decided to introduce an "interim plan for debt service payments" and to make partial payments to all of its creditors as a first step towards a more comprehensive long-term rescheduling of its external obligations.

Under the interim plan, the government first brought current its obligations uis-a-vis multilateral institutions. Secondly, the government allocated a certain percentage o£ export receipts and oohed capital inflows to debt service ,

The first payment under the formula was made on July 15, 1982. The formula did not contain a deduction for a minimum import level. As a result, creditors were paid on the basis of exports and non-tied capital flows only and were assured of a minimum debt service payment. Over the months, creditors could also expect higher level of debt service payments in line with any recovery of exports. The introduction of the interim payment plan in July 1982 - a month before Mexico's crisis erupted - dramatically improved the negotiation climate by demonstrating the government's intention to restore a sound contmctural relationship with its creditors. The plan was also significant in that it was the first time that a sovereign debtor had allocated a given portion of its foreign exchange receipts to debt service payments. The plan was fair and equitable in that creditors were allocated a percentage of foreign exchange based on the external arrears outstanding as of June 90, 1982 of each category of creditors (bilaterals, commercial banks and publicly issued securities).

On the eve of Mexico's debt settlement, in November 1982, Costa Rica was well advanced in its rescheduling negotiations with commercial banks. A term sheet including the main terms and con-ditions had been agreed upon. But when Mexico accepted at the end of 1982 to pay a spread of 1 7/8 percent over LIBOR, agreed to the
introduction as a reference rate of Prime and acquiesced to a re scheduling fee of 1 percent on the amounts restructured, Costa Rica's banks stated that the terms previously agreed upon with Costa Rica had to be revised in light of the Mexican precedent.

The debt crisis, which affected almost all countries in the Latin continent, led the banks to worry more about the establishment of a precedent than about the Particular circumstances of each debtor country. Hence, against the background of a generalized debt crisis in Latin America and in the context of an uncertain future environment, the banks' main concern was to impose in all rescheduling arrangements similar financial conditions. The bankers
argued that since Mexico was a lesser risk than Costa Rica, the "rescheduling market" - an absurd term given the circumstances - dictated higher spreads and fees for Costa Rica. The Costa Rican team argued that the circumstances of the two countries were very

different, that since Costa Rica waslvorse off it should benefit from lower costs and that the country's cash flow - affected perversely by the non-payment of Costa Rican exports by neighboring Central American countries themselvess struggBng with foreign exchange problems - did not allow for the higher outlays. But the bankers stuck to their claim that the terms and rescheduling conditions for each debtor are based on its credit rating compared with all the other debtors in the "rescheduling market" or, in other words, the lower the credit rating, the harsher the terns of the restructuring, Costa Rica in the end was forced to accept Prime as a reference rate, thus increasing the interest cost by about I percent during 1988 and 1984

But the Costa Rican negotiating team continued to argue persuasively that the country would only accept an agreement which was realistic in light of the projected cash flow. The Costa Ricans managed to convince the banks to include in the restructuring package publicly issued securities held by the banks for their own account and obtained an import trade credit facility amounting to 80 percent of interest in arrears which had accumulated over the 1981-1983 period; by verifying loan-by-loan the past due interest claimed by the banks, the Costa Ricans managed to save US$ 28.8 million or almost to percent of the interest in arrears; and finally, it is worth pointing out that Costa Rica was the first country obtain a multi-year rescheduling since maturities of 1983 and 1984 as well as arrears of 1981 and 1982 were included in the restructuring agreement.

Current Issues

The apparent success of the current ad hoc rescheduling exercises in countries like Mexico cannot cover up the fragility of the arrangements negotiated so far. Until now, the whole burden of the adjustment has been borne by the debtors. While fiscal deficits in the United States and other industrial countries are substantially larger today than in the 1970s, debtors havee been compelled to adopt draconian belt-tightening adjustment programs. These IMF inspired austerity packages include budgets being slashed, investments postponed, imports compressed, the local currencyy being devalued, and as a consequence, standards of living are being eroded. Growth of production has declined dramatically while unemployment has reached record levels. The adjustment has been more severe in small debtor countries due to a lack of adequate external resources. The IMF which in the cases of Mexico, Brazil, Yugoslavia et al, played a crucial role in "ann twisting" the commercial banks and forcing them to lend billions of dollars of additional money, has exerted less effort in assisting smaller debtors in mobilizing additional external financing.

The social fabric of most debtors has been severely-tested while their private sector has been affected by a lack of working capital as a result of massive devaluation and tight credit policies.

Growth is the only way out. But stimulating growth will be a difficult task. The public sector does not have the mean to invest on any meaningful scale unless the objective of keeping a lid on inflation is abandoned and the government starts printing money again. Hardly an option I The private sector, in addition to being decapitalized, is demoralized and in many countries is taking a wait-and-see attitude vis-a-vis its own government. Investments are postponed and at the first sign of overvaluation, capital flight resumes. Moreover, as a result of the drastic deflationary programs, in many countries the private sector is running at some 40 percent of capacity. Demand-pull inflation has in many cases given way to cost-push inflation.

The key to future growth is structural adjustment. But how do we get from here to there? The IMF is dealing with here and the World Bank is dealing with there, but nobody has stopped to consider how we will get from one to the other. In the case of a number of countries I have been working with, the World Bank sends very large missions to look into structural adjustment problems; but partly because the country has only a handful of policymakers who can deal with these issues and they are already engaged in marathon sessions with the IMF and the banks, structural adjustment is not really given as much priority as it should be. How much can an economic team really do? To understand the issues is nott easy, but to follow up and monitor the implementation of the structural adjustment programs can be an ever more trying task when the IBRI) shopping list of conditions is quite extensive. Sometimes, the World Bank is too ambitious in its undertakings at the cost of losing a great deal of its influence.

Finally, there has been a tremendous misunderstanding about the role of suppliers and multinational companies in the debt crisis. Much more attention should be given to repaying suppliers and keeping current vis-a-vis multinationals which in most cases, even in small countries, are in for the long-run, much in contrast to commercial banks, except the very largest ones. Hence some rearranging of prioritiess in the allocation of foreign exchange should be seriously considered, with short-term trade debt excluded from rescheduling arrangements.

A lot has been said about the recently agreed upon multi year reschedulings for both Mexico and Venezuela. Although these reschedulings clearly represent a victory of sorts for the two countries concerned, it is premature to conclude that banks will become more accommodating and that smaller debtors will necessarily benefit from these two precedents. In addition, virtually no grace period was granted and a potentially costly currency convertibility clauses was introduced in both reschedulings. In the case of Mexico it is important to keep in mind that the whole underlying assumption of the rescheduling is that within 6 to 12 months, Mexico can go back to the market. Mexico has already hinted that for 1985 it may need US$ 1 billion. Going back to the market shortly may be possible for Mexico but certainly not for Costa Rica, Chile, Peru and many other countries.

The real danger of the present situation is that with the "resolution" of the Mexican crisis, the sense of urgency which up to now prevailed – at least to some extent- in Washington, will be lost. Addressing the 1984 IMF/IBRD annual meeting, president Reagan declared "the debt crisis is over". But if the debt crisis is over, why aren,t countries like Blivia and Peru able to keep current on their interest payment? And why aren,t banks willing to resume voluntary lending? The debt crisis is far form over and the main issues- those of development and trade – have not even begun to be addressed. The challenge ahead is to preserve out multilateral system intact, and to give smaller and bigger debtors alike an opportunity to get out of the hole.

The debt crisis has politicized international lending to a great degree; there is a angerous temptation to further 'bilaterilize" and politicize financial and economic issues. Costa Rica, for example, has over the last two years, to a large extent relied on U.S. aid; but the inflow of dollars has not been without strings.

A Modest Agenda for the Future

An obvious lesson from the overlending of the 1970s is that current debt levels are excessive for a number of LCDs. This is particularly true in Africa and Latin America but also for some Asian borrowers, such as the Philippines.

For the poorest countries, serious consideration should be given to the cancellation by industrial countries of official debts. It is totally unrealistic to go year after year through Paris Club exercises and pretend that some day these debts will be repaid. Moreover, the amounts are in most cases insignificant as far as the North is concerned.

A number of reschedulings have tended to lump together short-term trade financing with medium- and long-term balance-of payment loans. This is a mistake. Except in exceptional cases, trade credits (both from suppliers and commercial banks) should be excluded from rescheduling arrangements. Trade credits are vital to the resumption of growth in world trade and future recovery. Food and oil bills have to be paid on time to aviod disruption in supplies which could cause serious social and political instability. If necessary, banks should be given assurances and even guarantees to keep trade credit flows from decreasing. Export credit agencies would also do well to revise their present policy of halting the extension of new credits to countries which have rescheduled their debts.

The World Bank should play a much more crucial role in reviewing a country's investment strategy and advising on the structural reforms which are necessary for increasing production, exports and employment in the medium- and long-run. The proposed reforms should be progressive and pragmatic and geared to addressing the most fundamental issues first. "Solving it all" won't work: either the program will be rejected at the outset as too "radical" and politically unacceptable or will not be successfully carried out due to difficulties in the implementation phase.

Such medium-term strategy may well require rethinking current rescheduling packages. It is in everybody's interest to give debtors some breathing space. Liquidity and financing

are needed if structural changes are to be implemented and investments in quick yielding projects stepped up. A number of proposals to alleviate the debt burden of LDCs have been made over the last 18 months but none have been translated into a blueprintt for action. Industrial governments have so far been unwilling to foot even part of the bill and commerciall banks have not been eager to cutt into their income.

For most debtors, net new money from commercial banks is an unlikely prospect. Hence, formulas linking their debt service payments to a certain percentage of exports receipts and untied capital inflows may be an option worth considering. In the 1970s, a 20 percent to 25 percent debt service ratio was considered very high; today most Latin nations' debt payments amount to 50 to 70 percent of their export receipts. A flexible debt service payment formula could be introduced to reduce the debt service burden; under such a formula a country would allocate, say, 25 percent of its export receipts to debt service payments. In order to stimulate growth, an additional 25 percent to 30 percent of export receipts could be set aside in a trust fund. The proceeds in that "fund" would be used for investment in the productive sector, completion of priority projects and injection of capital into the private sector. The allocation of the funds to various projects could be monitored by the World Bank which has a unique expertise in medium-term structural adjustment programs and investment strategies.

Debtors should follow suit on the "Cartegena Declaration" and, as a first step, enhance the flow of information among themselves. In small countries there is very little knowledge of what is going on between the big debtors and their creditors and what are the key issues in the negotiations.

Finally, as the private bank lending euphoria of the 1970s is neither desirable nor likely, industrial countries should renew their commitment to official assistance through a substantial increase in the resources of multilateral institutions such as the IMF and the World Bank. The financing role of the Bretton Woods institutions is seriously lagging behind the growth of international trade and even more behind the increase of international capital movements. The restrictive position of the U.S. administration and some industrial countries has also precluded the IMF's international reserve asset, the SDR, from gaining a significant role.

The U.S. would do well to reaffirm its leadership by reversing its current position and supporting a significant increase in the resources of the IMF and the World Bank, a major new allocation of SDRs, consistent, coherent and coordinated domestic and international economic policies, improved access by LDCs to the U.S. market and a significant reduction in real interest rates. To cope with the increasing financial pressures of the 1980s, the world economy has to be growing at a steady and sustained pace.

1/ The Wall Street Journal, October 16, 1984.

2/ Lazard Freres (Paris, New York), Lehman Brothers Kuhn Loeb (London, New York) and S.G. Warburg (London) are three investment banks which since 1975 have jointly advised'some 18 developing countries on a wide range of economic and financial issues including debt strategies.

3 For a more thorough account, see "The Role of Financial Advisors in Bank Debt Rescheduling?" by Christine A. Bogdanowicz
Binders in Sovereign Debt Restructuring, Columbia Journal of
Transnational Law, Volume 28,-Number 1, 1984.

4/ While the situation of each country is different, a detailed examination of Costa Rica is instructive; the Costa Rican authorities have kindly helped me in recalling the 1981-1988 debt rescheduling.

5/ The exact formula was:
A certain percentage of export receipts remitted to the National Banking System after deduction from these receipts of debt service payments due to multilaterals (`net export receipts"). This percentage varied depending on the level of net export receipts in each month and was as follows:
10 percent monthly "net export receipts" upto US$ 60 million; and 90 percent of the amount by which such net export receipts exceed US$ 60 million. 25 percent of untied medium- and long-term capital inflows available for remaining debt service.

6/ Non-American banks can switch, upto a certain ceiling, their dollar denominated loans into their own currencies.

CHAPTER 10
CurrentDebt Renegotiation Practices and Possible Improvements

Roy Takata, Jr.

Accelerating the growth on the part of developing countries is probably the shortest course toward our mutual goal of an economically better world to live in. Few people would deny this. The reality, however, is that the course for the world economy to struggle on is beset with hurdles, economic as well as non-economic. On an implementation basis, we witness a disarray of divergent, and sometimes conflicting, national and international responses. In final analysis, international debt issue is an issue of global income redistribution. What needs to be put right is not merely the financial side of borrower countries, but rather the real side of their external transactions as a whole. In subsequent paragraphs, this paper will briefly touch upon background factors for this issue of global concern, explain what needs to be done in a macroeconomic context, and endorses some of the ideas and schemes being discussed of late.

Background Factors

A series of large oil price escalation in the 70s, which is one of the major immediate background factors for the debt issue, constituted an abrupt change in the economic environment beyond imagination. In view of the unforeseen nature of developments, one can hardly blame countries, whether advanced or developing, for previously conducting economic management based on the premise of high growth. Countries were, however, forced to adjust their economic management inn response to higher oil prices and ensuing prolonged worldwide recession. In order to spread out the shock of a sudden change over a longer period of time, countries incurred fiscal deficits. This adjustment phase is not yet over.

For the financial resources required to mitigate the shock, advanced countries depended primarily on their domestic financial markets. In the United States, the choice of an unusual policy mix combining fiscal laxity with monetary restraint gave rise to an unprecedented high level of market interest rates, another major immediate background factor for the debt issue. Real interest rates in the United States used to be in the vicinity of 1 or 2 percent in and before the 70s, but jumped upto as high as about 10 percent in and after 1980. In the meantime, a prolonged worldwide economic recession brought about a dangerous rise in unemployment in in dustrialized countries and a resulting rise in protectionist sentiments, while sending down primary produce prices and causing a substantial deterioration of terms o£ trade for nearly all developing countries. In summary, major developments in the 70s constituted a sudden change of exogenous variables for the developing countries. There were no visible alternatives for these countries than to depend on external financing in the global economic readjustment phase.

Macroeconomic Responses

Against such a background, a solution must lie in finding a new sustainable level of economic activity. There must be ,a switch to a national economic management based on the premise of a new sustainable growth rate, which in all likelihood would be lower than before. There should be a proper recognition of the nature of the issue and of the response required of the governments and people.

A successful resolution of the debt issue hinges on the adjustment of current account imbalances or, put another way, transfer of income through increased exports from developing to industrialized countries. Protectionist sentiments emerging or increasing in industrialized countries undermines the resolution of the global issue, and should be strongly discouraged. On the contrary, the governments of thee advanced economies should endeavour to impart the benefit of recovery and expansion to the developing countries by forestalling protectionism and opening up its markets, so that the latter may have an export-led growth.

The U.S. interest rates are again on the rise since May 1984. While the particular policy mix being adopted in the United States has been successful in calming down the inflation, and in setting in motion a high economic growth and a substantial reduction of

unemployment, high interest rates add directly to the difficulties of the developing countries and threaten to cancel out favorable effects of increased activities in the United States on the export potential of developing countries. If historically high U.S. interest rates are of a structural nature as is often suggested and cannot be expected to go down within the foreseeable future, an important step to take in a global context would be to develop some device for "un-coupling" developing countries from taking a full blast of unusually high interest rate levels.

Another crucial step of global implications lies in ensuring the continued flow of funds. Given the limited amount of public funds available, the adjustment phase still depends on private sector finance for the great bulk of its fund requirements. What needs to be done under such circumstances is to construct an international framework for a spontaneous provision of funds by private sector financial institutions based on their code of conduct. At the same time, a suitable framework should be developed for utilizing the limited flows of public sector funds, including those of international financial institutions, in such a way as to have the maximum possible effect on an early construction of such a framework.

Some Specific Responses

Some of the ideas and schemes being discussed of late are worthy of serious thought. Some specific responses which may be expected to work toward a stabilization of the situation are given below.

(1) Currency Diversification

Inasmuch as high interest rates in the United States and the strong dollar in the exchange market are adding to the strains on the borrower countries, some relief should be gained by diversifying the currencies for borrowing. In the Working Committee No. 3 of the Institute of International Finance, Inc. in Washington, D.C•, for which I act as co-chairman, a study was made concerning the possible choice of currencies other than the United States dollar. After studying the possibilities of some 15 different currencies, the Committee came up with a finding that yen, Deutsche mark, Swiss franc and ECU look promising as substitute currencies. While the switching requires some technical arrangements on the part of agent banks, an option for the lender to use his home currency, instead of the U.S. dollar, provided that the exercise of such an option does not result in a clear disadvantage to the borrower, may be a very good point to consider in rescheduling and new money agreements.

The yen appears to be particularly promising in view of the recent public announcement by the Ministry of Finance. The Japanese Finance Ministry document released in May confirmed the policy of the government to remove barriers and foster a conducive environment for an increased international use of the yen. Some important steps have already been implemented to widen the scope of international use of the domestic yen as well as the Euro-yen.

(2) Multi-Year Rescheduling

The international debt issue has been dealt with on a case-by case basis so far reflecting the essentially different nature of each borrower country. Invariably, however, solutions focused on short term responses to secure the necessary flow of funds to developing countries. It is encouraging to note that some countries under debt strains have been able to show a real progress in readjustment efforts. Under such circumstances, a plan has been voiced recently to ensure a longer-term solution to countries with excellent adjustment performance. In that context, an introduction of multi-year reschedulings for countries with visible results in balance-of-payments adjustment is an appropriate remedy and will serve to stabilize the debt situation. Such a scheme should be encouraged vigorously within the framework of market principles under which commercial bank lendings must operate.

(3) Separation of Trade Finance from Reschedulings

In certain rescheduling experiences, weakness has been evidenced in that trade finance was made also subject to the terms of rescheduling. This practice tends to discourage new trade fmancings and constitutes a major constraint to the normal development of trade flows. In view of the crucial role of normal trade flows in the economic adjustment of developing countries, trade fmancings should be distinguished and managed in their own right, quite apart from the
longer-term task o£ bringing the balance-of-payment financing for developing countries back to normal.
A smooth management of trade flows through normalized trade fmancings would represent a step forward in the right direction both from the point of view of the borrower countries for whom the supply of essential goods and services would facilitate overall the adjustment process without unnecessary constraints, and. also from the point of view of the lender governments and institutions whose common purpose after all is to safeguard the fabric of international trade and financial flows while the adjustment of developing economies is in progress.

(4) Interest Capping Supported by International Institutions

If carried out judiciously without endangering the system, a widely publicized idea of interest rate capping can be an effective means of "decoupling" developing countries from the damaging effects of high interest rates on the U.S. dollar. The question is how a capping may be achieved without destabilizing the delicate balance of the financial market mechanism upon which the continued supply of necessary funds must rest. For instance, a scheme requiring private lenders to bear the brunt of introduced capping would be impractical under the present circumstances where restoration to voluntary lending to such debtor countries is so' critically in need.
A workable scheme could be for any excess-portion of interest payments to be borne ultimately by the borrowers but on somewhat easier terms than would be required in the absence of the scheme. Because global benefits can be derived out of a relatively small amount of financial burden as a result of a capping, this should be one of the areas where an international financial institution should seek to be instrumental. A study of initiative such as the one now reportedly underway in the World Bank would be very appropriate and constructive.

(5) Other Areas of Participation by International Institutions

There are other areas in which an expanded role of the international financial institutions such as the IMF and the World Bank can be very useful and advisable. By expanding their activities beyond the existing scope, they may well be more instrumental, for example, in extending to the developing countries some facilities that could be conducive to their export growth and import substitution. They could contribute to the reflow of trade financings in sufficient amount by participating in this area as the co-financier for the longer portion of maturity or at lower than market interest rates.
It is of vital importance to keep in mind that in all likelihood, there would be a rather restrictive limit to the supply of public funds. It is, therefore, very essential, when planning such a new scope o£ activities, to build in the assurance that disbursement of public fund will act as a catalyst to induce the inflow of private sector capital, so that a dollar defrayed by international institutions will have a multiplier effect on the international economy.

A Comment
The Global and Case-by-Case Approaches to Debt Problem

Sidney Dell

We have been told, in relation to the world debt crisis, that "there could not be a generalized solution because there was not a generalized problem".
This is a remarkable assertion. For many years, there were relatively few cases of official debt rescheduling at the international level - generally not more than, say, two or three a year. Mr. Jean Claude Trichet, Secretary-General of the Paris Club, has informed us that there were 17 cases of official debt rescheduling in 1983, 10 so far in 1984, and, of course, many cases of the rescheduling of commercial debt in addition. What kind of

factors, one wonders, caused such a tremendous increase in the number of cases of rescheduling after the crisis of 1982? How can such a large number of cases - and such a sudden increase in the number - be explained in terms of events taking place entirely at the level of each individual country separately? Granted that there were many cases in which governments compounded their own difficulties, it is impossible to explain the situation except in terms of factors operating across the board - that is, generalized factors.

Nobody, of course, is suggesting that each case does not have important special characteristics that need to be taken into account in devising solutions. In exactly the same way, every patient in a hospital has individual symptoms that are important in diagnosing and prescribing for his case, but the patients are all grouped in wards for particular diseases in which common methods of treatment are used, with individual variations. What the generalists are claiming is that there are global factors applying to all or most cases of serious indebtedness, and that in respect of these global factors, common approaches are necessary.

The global factors include the following:

1. The burden of externally imposed and unexpectedly high interest rates, high spreads, high fees and excessive bunching of maturities;
2. The burden of depressed terms of trade that are, or should be, reversible and that result from circumstances beyond the control of the countries concerned;
3. The schizophrenia of creditor countries in wanting to be paid but being unwilling to accept the foreign trade con sequences of being paid, and partially frustrating the efforts of debtor countries to expand their exports.

The relative importance of the global factors as against domestic factors varies from case to case, but in all cases the global factors are of substantial and often predominant significance. Thus an appreciation of the above and other general factors is indispensable in any valid analysis of the problems of individual countries and hence in any assessment of the solutions to be adopted.

We.have also been informed of the proposal that countries that are "performing well" should benefit from improved terms and conditions for rescheduling. One cannot but welcome, of course, any effort to improve such terns and conditions, which have been unjustifiably harsh in the past. The proposal is, moreover, precisely the type of general approach to all debtors that one has in mind in speaking of a global strategy for the debt problem. Obviously, a strategy o£ this type employed for Mexico cannot be withheld from Argentina, Brazil and Venezuela. But there may be a tendency to withhold such concessions from other debtor countries that have less political and economic clout than these four countries have, simply because their debts are not large enough to matter in the world setting as a whole and cannot endanger the financial stability of banks in the creditor countries. What the generalist is saying, among other things, is that the terms applicable in cases such as the four listed above should not be denied to African and Asian countries in a similar situation.

There are also difficulties in the idea of a reward for good behaviour in the grandmotherly terms suggested. There is an enormous and almost unavoidable element of subjectivity in the assessment of the economic performance of a country, and much depends on one's own political and economic assumptions. For example, some people are attributing the economic recovery and subsiding inflation in the United States to the brilliant success of supply-side economics and/or monetarist theories. Others are contending that the recovery has little to do with macro policy, but is the result, on the one hand, of public deficit financing in a particularly dangerous form, while the drop in inflation is attributed to a major extent to the unprecedented collapse of commodity prices which is bound to be reversed if the recovery is sustained and spreads to the rest of the OECD group. Interestingly enough, both schools of thought are probably wrong in certain respects, but the important point is this: if the United States had had to borrow to finance its huge balance-of-payments deficits, would it have been entitled to claim good performance on the criteria now being applied to Third World debtor countries? I will not suggest an answer, but I will say that an answer depends on what one's particular biases happen to be, and the same goes for any assessment of the performance of the major

debtors.
One may also have misgivings about the apparent implication that deficit countries (including the United States?) should be made to face the economic disruption that the Mexican economy has sustained, of which the last word may not have been heard. One should not, in particular, condone the unnecessary damage to the economies of the debtors that results from the fact that the creditors are not sharing the burden of adjustment in the degree that would be appropriate in the light of their own role in helping to bring about the crisis (through high interest rates, recession, protectionism and so forth).
Moreover, to say that the setting of appropriate maturities and avoidance of excessive bunching, as has taken place in the case of Mexico, are a seward for good behaviour seems strange. One would have thought that any responsible creditor would want to avoid a bunching of maturities in the short-run even for a debtor whose performance might be regarded as poor. What interest does a creditor have in making life more difficult for the debtor than is absolutely necessary? Is he interested in payment or punishment? The stretching out of maturities and the setting of fees and spreads at reasonable levels are things that many of us advocated two years ago, and even before that, and if that had been done the situation would be somewhat less acute today. Many of us have also advocated a reduction of interest rates, and o£ this, unfortunately, there is still no sign.
There is much to be said for the suggestion made by Pedro Pablo Kuczymski, President of First Boston International, when he addressed a meeting at the United Nations in May of this year. He said that governments should put pressure on the regulators to accept the proposition that in present circumstances a loan on which less is collected should not necessarily be regarded as a non-performing loan, and that such a loan may actually be more secure than a loan on which the usual charges are paid under compulsion. Coming from a private banker, that suggestion is particularly noteworthy.

Part III
Debt, Trade and World Recovery

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M.G. Mathur

CHAPTER 11
External Debt and International Trade: A GATT Perspective
M.G. Mathur

Introduction

The external indebtedness of a number of developingcountries has become a central concern in the international economy. The resource requirements for servicing unprecedented levels of debt, particularly in the economic conditions prevailing during the last few years, have imposed considerable strains on highly indebted countries. There have also been fears about the health of the international financial system in relation to the magnitude of the apparently high-risk exposure of banks in the indebted countries. A pressing question has been whether sufficient funds will continue to be made available by banks and other financial institutions in order to enable countries to maintain adequate levels of imports in the short-term and to service their debts in the longer-term and continue the development process.
As far as international trade is concerned, the debt problem has brought a new awareness to policymakers of the intimate link between internar final flows of goods and services on the one hand and financial flows on the other. At its most fundamental, the point is made that in the end the servicing and repayment of foreign debt requires the acquisition of foreign exchange. Foreign direct investment can constitute a significant source of foreign exchange, in the immediate sense of relieving balance-of-payments pressure, but the task of servicing debt and reducing excessive debt levels ultimately falls on the current account. In other words, it is the relation between imports and exports which primarily determines the country's capacity to repay its external debt.

Any analysis which seeks to understand the origins of the debt problem or prescribe solutions to it must, of course, go beyond the simple accounting relationship between imports and exports. The myriad ways in which various social, economic and political factors have interacted to produce the current situation are complex, and it is not surprising if there is some disagreement over the relative weight ascribed to these factors when discussing ways of dealing with the problem. Some of the difference in emphasis, however, clearly derives from the particular concerns of the commentator. In this paper, attention will be focussed on GATT's concern in this context, namely, the implications for countries' debt-servicing capacities of the conditions under which international trade takes place and the role of trade policy in influencing the adjustment of the external account.

Background to the Debt Problem

We are all familiar by now with the sequence of events and policy developments which contributed to the debt crisis: a few with foresight and many with the wisdom of hindsight point out that the rapidly rising current account deficits of many developing countries after the 1973 oil price rise could not be financed indefinitely by external borrowing, despite the very low or negative interest rates prevailing at the time and fairly widespread expectations that world demand would continue to be buoyant. By the time the debt crisis emerged in mid-1982, conditions in the world economy had indeed undergone marked changes. Oil prices had risen again rapidly in 1979-80, anti-inflationary policies in the major developed countries resulted in high interest rates, there was a severe deterioration in the terms of trade of the non-oil developing countries, and mounting protectionist tendencies became apparent in many countries. A number of oil-exporting countries also foundd that their oil revenues were not adequate to meet the expansion of their domestic expenditures. As the world recession took hold in 1980, indebted countries found it increasingly difficult to service their external obligations through exports. The domestic policies of many of the highly indebted developing countries would also appear to have influenced the evolution of the debt problem. It has been widely argued that excessive fiscal and monetary stimulus over several years contributed to growing external indebtedness and gave way to expanding budget deficits, high inflation and over-valued exchange rates.

At the risk of some analytical over-simplification, but without losing sight of the direct and indirect. influences that government policies inevitably exert on economic conditions, a distinction can be made between those factors contributing to the debt crisis which are in some sense self-correcting, and those which call for specific action on the part of governments. To the extent that the external financial difficulties of the highly-indebted developing countries coincided with a cyclical downturn in economic activity, then an amelioration of the latter trend may be expected to ease the debt problem. On the other hand, much recent analysis of the debt problem, and indeed of the problems faced by the world economy more generally during the last decade or so, has strongly suggested that many of these difficulties have their roots in the longer-term failure of countries to adjust effectively to changing economic conditions.

It is against the background of this realization that considerable attention has been devoted in. GATT, as well as in other fora, to the question of structural adjustment. These discussions have sought to achieve a clearer understanding o£ the sources of change in national economies, the role of government policy in promoting or impeding such change, and, particularly in a GATT context, the implications of this analysis for the contribution that international trade may be expected to make to resumed economic growth. There has been a widely shared recognition in these discussions that an open trading system has a central role to play in facilitating structural adjustment, irrespective of the sources of pressure for structural change. The significance of this conclusion for the relation between debt and trade is a theme that will be returned to below.

Considerable efforts at balance-of-payments adjustment have been made by the indebted countries to reduce their current account deficits from the peaks reached in 1981. It is notable that the initial reduction-of current account deficits occured in the context of the recessionary climate referred to above, with sharply reduced commercial bank lending, very high real interest rates, and the worst terms of trade for primary commodities in over forty years. In these conditions, adjustment in indebted countries involves sharp cuts in

existing levels of consumption and investment, with reduced or negative growth rates,, and with improvements in current account balances being achieved in virtually every instance through import contraction rather than export expansion. There is evidence that import contraction has been taken to a point at which it has led to an increase in idle capacity and unemployment, and has also impaired the export potential of the importing country. Moreover, adjustment to external imbalances through the reduction of imports by the debtor countries has also affected the export earnings of their trading partners, and created pressures for the contraction of import markets in some of the other developing countries.

Persistent adjustment efforts on the part of the indebted countries, efforts by creditors to maintain an adequate level of financing for the indebted countries, and the recent indications of economic recovery (particularly in the United States), provide some grounds for optimism in regard to the management of the debt problem, at least in the short-term. Largely as a result of stronger economic growth in North America, the exports of certain indebted countries have begun to expand again.' This potentially gives greater leeway for a renewal of import growth in the indebted countries. It may be noted, however, that at least until the end of 1983, very few of the highly-indebted countries registered positive rates of import growth. Furthermore, the magnitude of external debt is such that several countries will continue to depend both on extended external financing and a steady growth in domestic output and exports if they are to be able to service their debt. Also, historically high real interest rates do not show any immediate signs of falling and could be related to certain long-term trends in the demand for capital in relation to savings. Finally, and bearing in mind the above considerations, an orderly resolution of the current debt problem will require action to remedy certain underlying features of the present economic and trade policy environment and the way this environment has developed over the last decade or so. The effectiveness of such action would be enhanced to the extent that there is scope for trade policy improvements in developing countries which make for a more efficient allocation of resources and enhances their ability to benefit from more liberal trade policies in the developed countries.

The Present Trade Situation and the Relevance of Trade Policy

Mounting protectionism has been a characteristic of the world economy for some years now. Like all protective action, these kinds of policy measures have been designed to shield particular industries from competitive imports, thereby obviating the need for domestic adjustment and resource redeployment. Every time a government has accepted a demand for protection from one industry, it has become more difficult to resist similar demands from other industries. The idea that the protections' pressures are correlated with the business cycle, and that the present economic recovery will by itself result in a diminution of protectionism, has not, in the light of developments over the last year or so, proven to be well founded.

From the perspective of the heavily indebted countries, there are two particular aspects of current protectionism which may be noted. The first relates to the fact that the industries in the de veloped countries which have been most successful in securing protection from competitive imports are with few exceptions pre cisely the ones in which one or more of the highly indebted develop ing countries are internationally competitive. Apart from the "his toric" cases which include agriculture and textiles, this is also true with respect to such industries as leather, footwear, steel, and cloth ing, shipbuilding, consumer electronics and certain chemical roducts. The second aspect of the current protectionism which is note worthy concerns the modalities of protective actions. It has been widely observed that many of the measures taken in recent years have contravened, or circumvented the most-favoured-nation prin ciple of the GATT. The m.f.n. principle is the cornerstone of the multilateral trading system, and a particular advantage of this prin ciplelies in the greater security of market access which it affords individual countries irrespective of their size and economic strength. The growth of bilateralism, frequently taking the form of voluntary export restraints and orderly marketing arrangements, or other discriminatory measures not provided for or inconsistent with the GATT, has tended to make individual countries more vulnerable to restrictions in respect of particular products than they would be if the m.f.n. principle were safeguarded. The increase in discrimination has inevitably brought with it a higher level of protection in

general. It is to be expected that trade liberalization in those sectors where the highly indebted countries possess an established capacity and enjoy a comparative cost advantage would have an immediate positive impact on the export earnings of these countries. At the same time it is difficult to attach any figures to such increases in exports and the immediate impact on export earnings may remain limited in relation to the magnitude of debt service payments and outstanding debt. More than any calculations of gains in immediate earnings, the contribution which trade liberalization can make to the resolution of the debt crisis must be viewed against the back ground of the more general point that the entire economic policy environment in both debtor and creditor countries is crucial to the resolution of these difficulties. Apart from the immediate influence of interest rates, exchange rates and the capital supply on the size of the debt servicing burden at a given point in time, the capacity to service debt on a continuing basis and to maintain international credit worthiness depends on the rate of economic growth in debtor and creditor countries. International trade is an essential element in determining the allocation of resources which influences economic growth. In this context, it may be noted that the main benefits of trade liberalization are realized through the longer-term effects that changes in relative prices have on returns to factors of production in different uses and therefore on the efficient allocation of resources in the economy.

Another point relates to the sensitivity of investors to the effects of government decisions on their likely returns. In a situation where protectionist sentiment is prevalent and there is uncertainty about when and in what sectors new trade restricting measures are going to be applied, otherwise profitable investment opportunities may be rendered unprofitable. Alternatively, where there is a clear commitment on the part of governments to maintain an open trading system, including to reduce or remove existing trade barriers, there is a far greater likelihood that new investments will be forthcoming. In the case of the indebted countries, if such investment comes from foreign sources it is advantageous not only in augmenting production and export capacity in the medium-term, but also in that it reduces immediate balance-of-payments pressure. The fact that these "confidence effects" of trade liberalization are not easily measureable does not make them any less important.

The most important contribution international trade can make to ease the debt problem, therefore, is to foster an economic environment in which investment and production decisions can be made with a reasonable degree of certainty as to future government policy and on the basis of price signals which direct resources to their most efficient competitive uses. Moreover, it is not just the resolution of the debt problem that is assisted by an open trading system, but the entire process of economic growth and development.

An additional point which may be made in relation to action aimed at resolving the debt problem concerns the distribution of the burden of adjustment. It is an easy assumption that it is the debtor countries which have the responsibility for solving a problem arising from their own prior decisions and policies. Reference has already been made to the impiessive adjustment efforts undertaken by the indebted countries, as well as to the fact that the size and manageability of the debt servicing burden is influenced by a variety o£ policy (and other) factors outside the control of the indebted countries. In the trade field the case for shared responsibility is clear. Perhaps the simplest way of putting the point is to ask why the indebted countries should be expected to adjust to a set of international prices which is distorted by protectionism in the creditor countries, and which even in an ideal domestic policy setting, would prevent the indebted countries from allocating their resources to the most efficient uses.

At the same time, trade policies in the indebted countries can play a role in the management of their debt problems and their growth prospects. While possibilities for import growth in the indebted developing countries depend on available financial flows and export earnings, these countries could improve their possibilities of benefitting from opportunities in export markets through trade policies aimed at the efficient allocation of available -esources. This
could in particular involve efforts to reduce price distortions related to policies of excessive import substitution or export subsidization. The immediate consequences of such reduced reliance on import substitution for the balance-of-payments are likely to be more easily managed if the developed countries were rrducing their own import

restrictions.

Possibilities for Policy Action

The relation between trade and debt has been the subject of considerable discussion in the GATT, most notably in the Consultative Group of Eighteen and in the Balance-of-Payments Committee. In the Consultative Group of Eighteen there was wide agreement regarding the important contribution that trade expansion and the maintenance and strengthening of a predictable and stable trading system could make to world economic recovery and the resolution of the debt problem. It was also recognized that in the early stages of the adjustment process highly indebted countries often felt the need to introduce or intensify import restrictions, but this could at best be seen only as a short-term necessity because of the unfavourable consequences of such action for present and future export capacity and also because of the danger it could represent for the trading system. Not only may trade restrictions off this nature produce a chain reaction through the continuing reduction of profitable trading opportunities, but they may also give rise to the temptation to seek bilateral solutions to the problems of particular countries.
In the Balance-of-Payments Committee, recent discussions have focused specifically on the kinds of trade measures which might be taken to ease the debt burden for developing countries. The basic function of the Balance-of-Payments Committee is to examine trade measures taken by countries to deal with their balance-of payments difficulties where such measures would otherwise be inconsistent with the General Agreement. Provision has always been made in balance-of-payments consultations for the possibility of discussing external factors, including the trade policies of other countries, where it is felt that these have a bearing on the balance of-payments situation of the consulting country. Whilst the central purpose of the Balance-of-Payments Committee still entails an examination of the policies of the consulting country, the discussion of external factors has now become an integral part of the consultation process when this is requested by the consulting country. This arrangement provides a useful institutional mechanism to enable contracting parties to take a wider view of the ways in which their policies affect each other and alsoo to focus on the kinds of multilateral initiatives that could be taken by trading partners to alleviate balance-of-payments pressure faced by consulting countries.
In the discussions in both the Consultative Group of Eighteen and the Balance-of-Payments Committee there has been a recognition of the contribution that trade liberalization can make to the solution of the debt problems of developing countries by facilitating an expansion in the export earnings of these countries and a more efficient allocation of resources. In this context, a number of possible areas were referred to, including the reduction or elimination of tariffs, quantitative restrictions and other non-tariff measures, and restraint in the use of the safeguard, anti-dumping and countervailing duty provisions of the General Agreement. At the same time, it has been recognized that any trade action intended to relieve the balance-of payments difficulties of the indebted countries should be taken with due regard to the GATT principle of nom discrimination, bearing in mind any specific provisions in the General Agreement and related instruments which explicity allow differential and more favourable treatment for developing countries. It was thus recognized that if liberalization measures were applied only to exports of debtor countries this would penalize other countries which had until now been able to avoid the accumulation of large external debts. It was also noted in this connection that if there was to be sufficient security and predictability to permit a sustained expansion of ex- Ports, trade; liberalization measures would need to apply to countries on an across-the-board basis. None of this excluded, however, the possibility of giving priority to multilateral trade liberalization in respect of products of special interest to the highly indebted development countries.
The current GATT Work Programme, established at the November 1982 Ministerial meeting, occupies a central place in the efforts underway in the GATT to strengthen and improve the international trade policy environment as it affects the international economy and thys the debt and balance-of-payments situation of developing countried. All the elements contained in the work programme are obviously concerned in one way or another with trade liberalization and the maintenance of a secure and predictable trading environment. However, from the perspective of the indebted developing countries, certain elements in the work pogramme are of particular interest.

The sector cases of agriculture and textiles have already been referred to above. Trade in agriculture has never been fully integrated into the GATT system and in the newly-created Agricultural Committee. There is taking place for the first time in GATT's history an examination of the entire range of policies affecting agricultural trade. The Committee has a mandate to deal more defectively with problems affecting trade in agriculture, notably as these relate to the use of restrictive import measures and export subsidies.

In the case of the textiles and clothing esector, which has long been exempted from normal GATT disciplines, a major study has recently been completed by the GATT secretatiat on the basis of which an exploration will take place of the possibilities for increased trade liberalization in this sector, including a return to normal GATT rules and disciplines.

In view of the proliferation of bilateral arranfements and other restrictive measures of a selevtive nature, and the resulting uncertainty for the trading system, particular impottance attaches to the efforts being made to reach an understanding that would provide for greater security and equity for both importing and exporting countries in the use of safeguard measures. To this end, consultations ate taking place with a view to arriving at a closer definition of the conditions under which safeguard action can be taken. In this context particular attention is being given to the links between the use of safeguard measures and structural adjustment.

An examination is also taking place of the modalities for further progress in removing quantitative restrictions and other non-tariff measures.

The Work programme likewise embraces a programme of consultations and appropriate negotiations aimed at priority action to remove trade obstacles affectingg developing countries and promoting a better shared understanding of policy measures that could help to expand trade between developed and developing countries.

While some aspects of the Work Programme may be separately identified, the basic objectives are to strengthen trade policy rules and disciplines, to reduce uncertainty and to promote more effective action against measures that restrict or distort competition in general and restrict trade opportunities for developing countries in particular. A number of countries have suggested that a new round of multilateral trade negotiations would serve to engage an effective collective effort by GATT contracting parties to this end.

Summary and Conclusions

There is no easy solution to the debt problem. Just as its origins are located in a series of events and policy decisions, its solution requires joint action on several policy fronts, based on a recognition of the shared interest of all countries in a satisfactory outcome. This common interest goes beyond the immediate concerns of adequate liquidity in debtor countries and the health of the financial system in creditor countries, touching on the process of economic growth itself. International trade and the policy conditions under which it takes place are only two of the factors which bear on the debt problem and they in turn affect and are affected by numerous other variables which determine the rate of economic growth and by extension, the nature and magnitude of the debt problem.

A fundamental question is whether the balance-of-payments adjustments process in the indebted countries will rely mainly on import contraction or export expansion. There can be no doubt that improving the current account balance entails far greater costs in terms of austerity and unemployment in a protectionist environment than in a liberal trade environment. While external balance and non-inflationary growth require appropriate monetary and fiscal

policies, trade policies have an important role to play in promoting structural flexibility and the efficient use of resources.

Even a cursory examination of the current commercial policy situation, and the incidence of protection in several industries including agriculture, textiles and clothing, steel, electronics and a range of others of immediate interest to many of the highly indebted countries, leads inevitably to the conclusion that there is significant scope for trade liberalization to contribute to the solution of the debt problem. Whilst it is recognized that the immediate benefits of trade liberalization may be important, the real payoff occurs in the longer-term as economic growth is stimulated by the adjustment of production structures to new trading opportunities. Moreover, trade liberalization

initiatives need to be taken on a non-discriminatory basis if their benefits are to be fully realized and durable.

Finally, since a significant gain from trade relates to the effects on production structures of the integration of domestic relative prices with the pattern of international prices, it follows that the more generalized liberalization efforts are across sectors, the greater the gains of trade liberalization will be in terms of efficiency and growth. In relation to high levels of indebtedness, the policies of the indebted countries themselves are important to a satisfactory solution of this problem. At the same time, trade liberalization action by their trading partners is required in order to remove present distortions in world prices and to permit indebted countries to allocate resources in an efficient manner.

1 / While there was only fairly low export growth in a limited number of the most indebted countries in 1983, preliminary evidence indicates that several countries are experiencing considerably stronger export growth in 1984.

1. **1984**

1984 was a good year for the global economy. World output increased by an estimated 4.2 percent, compared to an increase of only 2.3 percent in 1983 and no increase at all in 1982. After declin ing in both volume and value in 1982, world trade returned to a positive, if modest volume growth in 19833 and registered a strong increase in 1984.

CHAPTER 12
Will the Third World Recover from its Present Economic Crisis?

Shahid Javed Burki

The principal purpose of this paper is to demonstrate that while 1984 was a good year for the world economy, it does not seem to have set the stage for a broad based recovery from recession in all parts of the globe. The situation remains fragile; problems abound in all countries, even in those which have thrived in the past two years of economic recovery. "Business as usual" approach is unsatisfactory given the fragility of the current economic situation. There is danger of a severe downturn in the economic fortunes of all nations, particularly of those developing countries least able to afford further postponement of real growth.

The paper has four parts. The first examines the situation from the perspective of 1984 and identifies the areas of weakness that remain. The second looks at the developing countries' trade prospects. It reaches the conclusion that a significant increase in develop-ing countries export earnings is contingent upon the occurance of a profound change in the protectionist policies of the industrial world. The third part of the paper examines the prospects of capital flows of various kinds to the developing countries. Once again the conclusion reached is a pessimistic one. It does not seem that large increases in capital flows would occur on their own. The fourth and final part of the paper presents two possible scenarios for the global economy; one, the more hopeful one, contingent upon the pursuit of rational economic policies in all parts of the world, and the second, the more pessimistic one, in which no significant change occurs in the policies being presently pursued. The first scenario sees sustained economic growth eventually returning to all parts of the world, including the countries of sub-Saharan Africa. The second scenario sees another global recession taking hold, this time with the consequences even grimmer than those produced by the recession of the early eighties..

1. **1984**

1984 was a good year for the global economy. World output increased by an estimated 4.2 percent, compared to an increase of only 2.3 percent in 1983 and no increase at all in 1982. After declin ing in both volume and value in 1982, world trade returned to a positive, if modest volume growth in 19833 and registered a strong increase in 1984.

Table 1

Changes in World Output and Trade

(w change)

	1981	1982	1963	19841
Real Output				
Countries				
IndusMal	1.9	-0.5	2.6	4.8
OWelopin9	3.3	1.9	2.0	4.1
HIOh-Income ollrozportln9	0.1	-1.7	-7.0	0.4
East European	1.8	2.11	3.00	2.6
world	2.0	0.0	2.4	4.2
Trade				
countries				
Industrial	2.2	-1.6	2.0	9.0
Developing	-1_3	3.4	5.2	7.6
World	1.5	-2.0	2.0	6.4

1/ changes In 1984 are estimates, tkox for early years are actual.

Source: The World Bank From Recovery to Sustainable Long-term Growth', (March 1985), paler prepared for the meeting of the Development committee, April 1985.

The averages of Table 1 conceal wide variations among countries. The 4.8 percent increase in the growth of real output in industrial countries was the consequence of a very robust recovery in the United States. In the U.S., ONE had declined by 2.1 percent in 1982 but recovered to 3.7 percent in 1983 and produced a very sharp increase of 6.8 percent in 1984. During the first six months

of 1984 the U.S. GNP increased by nearly 11 percent. While Japan never went into a recession - the growth in its GNP remained above 8 percent in both 1982 and 1988 - the rate of increase in its output jumped to 5.7 percent in 1984. In the second half of 1984, while the rate of recovery slowed dowri in the United States,-Japan resumed its traditional place as the fastest growing industrial economy. But Europe has made only a modest recovery from recession: re-.n cession in Europe began a year earlier than in the United States - in 1981, its real GNP declinedd by 0.1 percent while that of the United States increased by 2.9 percent. Since 1981, the GNF growth rate in Europe was positive but not very high; at only 2.8 percent in 1984, it was only a third of that achieved by the United States. The growth performance of developing countries has been even more uneven. Oil-exporting middle-income countries were the only ones to suffer a decline in their GOP; for all other country groups, output continued too increase even during the period of recession in the industrial world. But there were wide variations, with the low-income African countries barely able to grow while the rate of growth in the poor countries of Asia reached record levels. The slowdown in African growth had begun to occur tong before Europe and the United States went into recession. In the middle-income oil-importing countries, the slowdown was sharp

Table 2
Real GDP Growth in Developing Countries

Country n(Ouw	1981 1982	1983	198
Low lpcom	5.0	7.2	6.6
Africa	0.7	0.7	1.6
Aala	5.4	7.8	7.1
MiddleIncome	0.8	0.0	3.1
011-Importers	0.8	0.7	3.3
OlI xporterc	0.9	-1.0	2.7
All developlng	1.9	2.0	4.1

Source: Tne worm Sank. Woo d Davelopnlent Repoft, [illegible]

And directly the consequence of what was happening in the industrial world. In facrt, if the growth rates of tablte 2 are further disaggregated, then the extent of the impact of recession in the countries of Latin America is fully revealed. Their GDp declined by 0.9 Percent in 1982 and by another 2.9 percent in 1983. A similar disaggregation for sub-Saharan Africa shaws a severe decline in GDP in the western part of the continent. Between 1982-84 West African GDP declined by over 7 percent, while Latin America countries registered some growth in their output in 1984. In 1984 the countries of West Africa remained in recession.

The above analysis points to the fragility of the present situation. Recovery in the industrial world is uneven-much more pronounced in the United States and Japan than in Western Europe-and has not spread to all developing countries. And where it has occurred, it is largely the consequence of the very sharp increase in domestic consumption in the United States. As can be seen from the data of table 3, it is the very wide difference between domestic demand and output in the United States – more than one percent of the GNP in 1983 and nearly two percent in 1984 – that caused the United States to import so much in 1984. Domestic consumption was much lower than GNP increase in all other parts of the consumption growth that pulled Europe out of recession and quickened the pace of economic expansion in Japan. Therefore, if the process of recovery falters in the united Sates, it could pull down with it the rest of the world. A number of factor could cause a slowdown in the United States: the dollar could depreciate suddenly in value, the government may not be able to close the fiscal deficit by much, the interest rate may remain high in real terms, the trade deficit may keep on expanding. All these factors are inter-related, deterioration in could produce a dserious snowball effect.

Table 3

Growth of Output and Consumption of Industrial Countries:

1981-84 (% chan)

	1981	.1952	198 2	19841
Real ONP United states	2.5	-2.1	3.7	6.8
Japan	4.0	3.2	3.0	5.7
Europe	-0_1		1_3	2_3
Total	1.9	-0.5	2.6	4.5
Real Total Domestic Demand United States	3.1	-1.2	5.0	8.7
Japan	2.1	3.1	1.6	4.2
Europe	-1_a	05	ly0	2y0
Total	1.1	0.0	2.7	5.2

If Estimate.
5ouru: DECO, Economic Outlook (Paris. various Issues)

For whatever reasons, if the rate of growth slows down in the United States, it could have serious consequences for recovery in Europe and Japan. The impact of the slowdown would be even more serious for the countries of the developing world. As shown in Table 4, the increase in developing countries' imports from the United. States have been dramatic in 1984. Any faltering in the U.S. recovery would, therefore, slowdown the increase in developing countries, exports of which in turn would have a serious affect on the Third World's capacity to import. With the capacity to import thus seriously impaired, developing countries could easily relapse into a state of recession.

The analysis above points not only to the fragility of the present situation but also to the fact that some of the old relationships between economic activity in various parts of the world might have been weakened considerably. This weakening may be the direct result of the deep recession of the early eighties. Recession quickens structural changes - obsolete means of production that might continue to produce in a situation of high demand can quickly go out of business when aggregate demand falls; emergence of surplus capacity during recession is often an. invitation to plant managers and owners to bring in new technologies. Because of these recession

Table 4

Industrial Countries' from Developing Countries

(% change)

United states	1983	1984
from Africa	-24.3	4.0
east An.	16.3	
South Asia		18.6
Latin America	47.8	16.6
	10.9	16.0

Total	6.0	22.0
Japan		
from Africa	-11.8	11.1
East Asia	-4.0	21.6
South Asia	3.0	-1.8
Latin America	6.4	15,3
Total	-2.0	17.7
U.K., Japan, and Germany		
from Africa	-lA	114
East Asia	5.2	3.1
South Asia	-18.5	14.8
Latin America	6.5	0.0
Total	-0.5	4.7

Source: iMF,DirectlonofTmde(VarIWSissuaq.

induced structural changes, the mechanism of transmission that worked so well between the developing countries on the one hand and the industrial world on the other might have lost some of its original strength. This might be the case, in particular, in trade between developing and developed counties.

II. Trade and Third World Recovery

The value of developing countries' exports increased by nearly 4 percent in 1984 as against an increase of less than 1S percent in 1983 and a decline of nearly 3 percent in 1982, but it is by no means certain that this rate of expansion can be maintained in the future. There are several reasons for being cautious, the most important of which are unabated and growing protectionism t has in to Indulnany countries and rapid technological change developed countries since the early 1980s.

As show in Table 5, "management of trade" become rampant in the pre-recessionary period and most of it was the result of the restricted trade policies of the OECD industrial countries. Whereas the extebt of "management" in world trade increased from 40 to 48 percent between 1974 and 1980, that in the developing countries came down from 50 to 47 percent. In the 22 countries of the OECD, the ratio of managed trade increased from 36 to 44 percent during.

Table 5

Managed Trade by Countrie3

(percentage of 1974 trade)

	All goods		Mfnufaotules	
	1974	1980	1974	1980
	33	43	U	6
Franc	37	47	0	16
WITadY	4 4	52	0	17
Italy	39		0	16
EC			0	Q
	56	59	6	21
Japan	36	46		
U.S.P.			q	17
	36	44		60
OECD	54	65	46	23

N a.oIorte0	50	37		24
	40	48	13	

source: AM. Page. The Revival of ProtaotIOnltT and 14 conSequences for EUrope".

The same period. What is even more worrying is the fact that the incidence of management increased greatly in the case of trade in manufactures. It is this part of the trade which has been the most dynamic in the case of the Third World – in 1984 trade in manufactures increased by 9 percent as against a total expansion of 4 Percent. Therefore, increased incidence in management in manufactures trade is of great concern for the developing world.

Table 6 shows management of trade by commodities as it has emerged over time. Once again, commodities and goods of special importance to the developing world have been seriously hurt.

Table 6
Managed Trade by Commodities

(In percent

Snare or trade controlled

commodity	1974	1979
	30	31
Flan	6	71
Silk Flbrea	21	35
TaxtiI S	16	66
Iron auldste&	18	82
Shlpa	20	48
Clothing	1	32

Source: Spa. Pege.'The Management of International Trade", In R. Major (editor),

Tables 5 and 6 provide data for the pre-recessionary period. While similar detailed statistics are not available for the more recent period, it is certain that the incidence of management increased further. For example, in 1983 non-tariff restrictions were applied to some 30 percent of total consumption of manufactures in the major industrial countries, compared with 20 percent in 1980. This increased protectionism was not aimed only at other industrial countries. For instance, the share of five Asian countries' manufactured cxports subject to trade restrictions doubled from 1980 to 1983 - from 15 to 30 percent. Moreover, sectors where non-tariff increases have been introduced by industrial countries are often those in which developing countries have comparative advantage and in which costs to consumers are considerable. To give one other example, the annual cost of protection in terms of the price ultimately charged from the consumer is more than nine times the cost of compensation per job in the footwear industry and four and a half times in steel. In other words, it is not only the exporters in the developing world that have suffered from trade management and Protection of inteal aid a very heavy price.

The other important reason for the Possible weakenng Of this trade link between the developed and developing countries is the rapid technological change occurring in the former. Hard evidence in terms of the impact on industrial countries is not available: what is available are anecdotes of what technological improvements may have done for industrial countries' imports. To give one example, new metalurtical development have reduced the weight of auto-mobile being manufactured now in the U.S., japan and Europe. This has reduced the omport content of metals, in particular steel and copper, in the end product of the automaobile industry. The development of fibre optics has also caused the widespread displacement of copper from telecommunication cables. The use of digital equipment in clothing industry means that "size fitting" to in divddual specifications is possible causing East Asian manufactures of clothing to lose some of their competitive edge.

The most significant impact of such technological improvements has been in terms of commodity prices: Prices have failed to recover from their slump of the early 1980s: in 1984 they are expected to have declined by 2.5 percent on top of a cumulative decline of over 15 percent in 1981 – 83. The sharpest decline has come in non-fuel commodity prices – above 30 percent in1981- 83 and a further 2 percent in 1984. Comsequently, the value of sub-Saharan Africa

countries' exports, almost exclusively primary commodities, fell by almost 40 percent in 1981-83. A useful way of gauging the changing relationship between the growth of industrial economies and development countries' exports to them is to work out the formers' import elasticities. This is done in Table 7 which shows a decline in overall import elasticity in 1973-79 compared to 1960-73. However, this decline was due entirely to the very sharp decrease in the elasticity for commodity imports. One the other hand, there was a significant increase in the elasticity for the imports of manufactures.

Table 7
Changes in Industrial Countries Import Elasticitie
for Third World Trade

	1950-73			1973.78		
	Import elasticities: overall				18&90	
	Manufacture		1.3			
	Primary	8.0		1'1	1.8	
	1.0			3.8 0'3	3.8	I
Source:	The World Bank;				0.8	

The world Bank: world Development Report,1985 (Washington,CD).

The last column in the table above is from the world Bank's growth scenario for the developing countries in the period 1985-90. It assumes a rate of growth of 3.0 percent per annum in the industrial countries which would be transmitted via trade and capital flows to the developing world and produce there a rate of growth of 5.0 percent per annum. The assumed trade elasticities are optimistic in that they precent a significant change in trend from recent years, in particular in the import elasticity for primary commodities. These assumptions seem very optimistic, particulary in the near term. If trade between developed and developing countries will not provide the latter with resources for investment then the only other option available is to bring about an increase in capital flows. The prospects here are also not very good.

III. Debt and Capital Flows and Resumption of Third World Growth

We have seen that trade is failing to offer the full benefits to developing countries 1f economics expansion in the industrial world; capital flows are doing even less well. Medium- and long-term borrowings of developing countries from both official and commercial sources, after having increased at the rate of 6.9 percent per annum in 1965-73 and 4.4 percent in 1973-80. Long- and medium-term lending to developing countries fell further in 1983. Although disbursements by official lenders increase by US$ 2 billion, it was accompanied by a decline in disbursement by private creditors - by USS 30 billion. Net disbursements of official development assistance (ODA) from all sources fell from nearly USS 40 billion in 1980 to less than USS 36 billion in 1983 And while the nominal value of direct investment resource flows to developing countries increased by 10 Percent per year in the last fifteen years, their real value hardly increased at all. It is estimated that remitted earrings now constitute over half of the measured flows of direct investment in developing resent the developing Countries. These reversals in recent years of various forms of flows present the developing countries with very serious problems.

One consequence of this sharp decline in external capital flows to developing countries was the equally sharp adjustment in their balance-of-payment deficits. As shown in Table 8, the estimated deficit in 1984 was only a third of that in 1981. In 1981, the combined balance-of-payment deficits of all developing countries was equivalent to 5 percent of third total GNP; by

1984 the ratio had come down to just over 1 ½ percent.The reduction was most severe in middle-income countries, in particular for those exporting oil.

Table 8

Current Account Balance of Developing Countries: 1980-85

(billion of US dollaers)

	1980	1981	1982	Estimated 1983	1984
Low-Income Countries	-15.5	-12.7	-6.0	-5.9	-7.7
Asia	-9.6	-6.3	-1.4	-1.0	-3.1
Africa	-5.9	-6.4	-4.6	-4.9	-4.6
Middle-Income Countries	-52.5	-92.3	-93.2	-50.8	-27.9
Oil-Importers	-54.0	-66.0	-57.7	-39.7	-24.4
Oil-Exporters	1.5	-26.3	-35.5	-11.1	- 3.5
Total Developing Countries	-68.0	-105.1	-99.2	56.7	-35.6
Memorandum Item:					
Current Account as % of GNP	-3.4	-5.0	-4.7	-2.6	- 1.6

1/ Fingures refer to a sample of 90 developing countries. Official transfers are excluded.
Source: World Bank, World Development Report,1985.

The important question is whether the flows of capital to developing countries can be revived in the near future? This question can be answered in several parts, separately for different types of flows. Let us take commercial flows first. It was the tremendous increase in the availability of commercial capital from Eurodollar sources that 'Was able to sustain import flows to thr developing countries in the mid-seventies and consequently made it possible for them to continue to grow despite the slowdown in economic activity in the industrial countries. Another consequence of this was the rapid build-up in debt, in particular by those countries that were considered to be creditworthy by the commercial lenders. Debts disbursed and outstanding of developing countries increased from US$ 135 billion in 1974 to an estimated US$ 655 billion in 1984. Not only did this increase occur only in the middle-income countries, a number of low-income African countries were also able to borrow - there was a four-fold increase in their outstanding debt:: it went up from US$ 7 billion in 1974 to US$ 28 billion in 1984. This happened since the commodity price boom of the mid-seventies made a number of African countries seem creditworthy to commercial lenders. The attraction that developing countries had for commercial lenders suddenly disappeared in August of 1982 when Mexico found that it exhausted its external resources and could not service outstanding debt. Thereafter, the flows of commercial money that have been maintained to the developing world are mostly of an "involuntary" type. Commercial lenders have been prepared to provide very little new money. There are now substantial negative transfers from the countries of Latin America to their commercial lenders.

Before commercial capital came to play such an important role in the developing world, private direct investment was an important source of external finance for many developing countries. As

already indicated above, this type of resource flow has also become negative for several developing countries in that repatriated profits exceed new investments.

The prospects for increasing foreign private direct investment in developing countries may be somewhat better than that for increasing large flows of commercial capital. Real interest rates are likely to remain high since investments are more attractive for developing countries than borrowing. Private firms, given the demographic change occurring rapidly in the industrial countries, are now more willing to seek investment opportunities in those countries in which there is an abundant supply of trained and disciplined manpower. However, even with these positive developments, foreign private investment will remain small relative to the developing countries' need for external resources. It will also be concentrated in a few countries and in a limited number of industries.

Concessional economic assistance is critical for low-income developing countries now in the process of undertaking important economic reforms aimed at improving their long-term growth prospects. While the requirements for Official Development Assistance (ODA) by developing countries remain substantial, supply constraints have become increasingly evident. The 1980-83 period marked the first downturn in total net ODA flows. Although the flows from industrial countries increased marginally over the period, total net disbursements have declined slightly in real terms since 1982. This is due to the stagnation of ODA levels in some donors, and decline in ODA flows from high-income oil-exporting countries.

In sum, the resumption of significant quantities of commercial capital flows and availability of private direct investment in large amounts will not be possible in the medium-term. The prospects for the period 1985-90 do not look good. At the same time, there is not enough political support in the donor countries for making available large amounts of concessional monies to the poor countries. If expansion in trade is also likely to remain sluggish over this period, then it would appear that the developing countries are faced with a very serious dilemma: they can either severely cut down on new investments and thus further affect long-term growth prospects or they can press the developed nations to undertake institutional reform to ensure that adquate amounts of external flows become available. In this respect Bretton Woods and associated institutions -the World Bank, International Monetary Fund, regional develop ment bank -have a very important role to play.

While much of the recent discussion about the future role of these institutions has focussed on the crisis situation in sub-Saharan Africa and the heavily-indebted middle.income countries, they have a responsibility to look beyond the current crisis and to address those investment and institutional development issues that are crucial for sustaining progress in the long-term. A number of changes have occurred already in the roles being played by these institutions. To take one example, the proportion of World Bank lending devoted to structural adjustment loans and a level of ad1518 j st pent to nstot s sectOral increased sharply in recent years,purpose of this type of lending commitments in 1983-85. The main purpose been to provide quick disbursing money to those developing countries that were prepared to undertake adjustment in their domestic economies - adjustment to the changes that have occurred in their external economic environment. Changes have also occurred in the way the World Bank is financing projects. There has been increased emphasis given to maintenance and rehabilitation. Those and other changes mean that the World Bank is now in a position to play a more meaningful role in terms of providing increased financing to its borrowers. But to do this will require a large increase in its capital base - another General Capital Increase (GCI). What has been said about the World Bank also holds for other international financial and development institutions. it would seem, therefore, that the future economic prospects of the developing world – in particular over the period 1985-90 - depend upon the international community to enlarge the financial base of those multilateral in stitutions that have evolved their policies and practices to meet the changed circumstances of their borrowers.

Iv. Some Possible Scenarios

Progress in recovering from the economic and financial difficulties of the early 1980s has been tangible, however, important imbalances persist. This is true of the progress in adjustment made by different groups of debtor countries and of the economic stances of the industrial countries. it is also true of real interest rates and, very importantly, of attitudes towards trade and the reviving tendency of protectionism. Given the scale of the paoblem reflected rtsuch
in the late 1970s and early 1980s -variables as the size of developing countries' debts and their debt service ratios, and the level of developed countries' budget deficits - these will need to be

addressed and progressively corrected over a period of years for real stability to return to the world economy. For both developed and developing economies the necessary changes will be more easily effected against a background of steady, reliable and strong overall output growth. Indeed, without such a background it is questionable whether rigidities in the developed economies could be successfully removed, and whether - in cir- cumstaces of continuing high real interest rates and uncertain access to export markets - developing ountnes could maintain the momentum of adjustment needed to sustain creditor confidence and avoid a recurrence of widespread financial Disruption. For both groups of countries a failure of growth would involve high social and political, as well as economic, costs.

Both industrialized and development countries need to implement over the period 1985-90 a number of policy change in order to establish the basis for sustainable growth in the world economy after 1990. The necessary adjustments to policy are moderate and should be implemented gradually, but they cannot be long delayed.

Of transition to renewed worldwide economic growth in a reasonably stable price environment, or one of disorder and decline. The latter scenario is easy to imagine. Continued budget deficits in the United States at the level projected by official authorities under the assumption that no additional policies are initiated to contain them, would feed a continued and growing current account deficit. This would become increasingly difficult to finance, putting upward pressure on interest rates and raise expectations of future monetary accommodation. In such an environment, a growing trade deficit in the U.S. and continued slow growth in Europe would feed protectionist pressures which would easily lead to increased trade protectionism. Growth in the industrial countries would falter and would not be, on average, greater than 2.5 percent for the rest of the decade. Export of the developing countries would suffer both from a slow growth of overall demand and protectionism, and grow only at a rate of perhaps 3 percent. Overall GNP growth in developing countries would amount to only about 4 percent; only about 3 percent excluding India and China whose relative in ward orientation and low debt would, for a time, somewhat protect them from the implications of this scenario. Taking into account the decline in their terms of trade, most developing countries would face stagnating or declining per capita incomes.

But this picture might be over optimistic. The financing crisis of the U.S. deficits might emerge suddenly and precipitate a sharp recession with growth much below the average for a year or two. This would have obvious imphcadons for the developing countries debt servicing ability. Even under thscenario codepicted above, thedeveloping countries would have to generate surpluses to service their debt, under conditions of slow growth. Industrial countries would have to be willing to accept corresponding trade deficits despite their unemployment. Commercial banks, through involuntary lending or rescheduling would have to continue slowly increasing their exposure in developing countries, despite the latters'impaired prospects.

However, this somber scenario is avoidable. A timely and credible reduction in the U.S. fiscal deficits could still bring about a much better outcome. The exchange value of the U.S. dollar could decline gradually, and so could real interest rates in dollar terms. If this is accompanied by some relaxation of financial policies in other industrial countries (mostly monetary in Europe, largely fiscal in Japan), and by adequate wage and other factor cost restraints, industrial countries could grow at a rate of 3 percent for the remainder of the decade and somewhat faster thereafter. Protectionism could then be more easily contained and developing countries' exports could grow at a rate of about 5 percent. Middle-income developing countries would then have an environment which could allow them to rebuild their debt service capacity and commercial banks gradually return towards modest, voluntary lending to them. But even then, developing countries will need significant increases in additional institutional flows - from the World Bank and other multilateral institutions. Under this scenario, developing countries' GDP could grow at 5 percent allowing room for growth in per capita incomes. Only in low-income sub-Saharan Africa would income growth be barely sufficient to offset population growth.

Of course, the international environment, determined by the industrial countries' policies, is only a necessary, not a sufficient condition, for such an outcome. Developing country policies would also have to continue to improve, both in moving towards reduction of internal and external imbalances and in terms of greater factor movement flexibility and improved pricing.

The outcome outlined above is not the best possible. One can imagine better ones. They would require firmer correction of financial imbalances in the industrial countries, rolling back rather than containment of protectionism, and more capital flows. They would also require bolder movement toward improved policies in the majority of developing countries. While one cannot realistically count on this happening within the transition period under consideration, it is perhaps not too much to fix such improved policies and the faster growth they entail as a realistic and

attainable goal for the 1990s.

CHAPTER 13
Debt and the System of Trade and Payments
Shahen Abrahafnian

Introduction

UNCTAD's Trade and Development Report of 1984 situates the present-day debt crisis of the developing countries in the overall context of how the international monetary, financial and trading system are ordered. After examining the continuing world economic crisis, the evolution of the trade and payments system and the need to reform the system, it concludes that the debt problem must not only form part of the core of any agenda of reform of those systems, but can only be satisfactorily resolved in the context of such a reform. The Report goes on to stress that since the debt problem is urgent and immediate, it cannot be ignored; and it cautions that "the system itself will inevitably be affected, and its long-term evolution heavily influenced, by decisions regarding debt in the immediate future".

The reasoning of the Report suggests that the international community now confronts a critical choice: whether to continue, as in the past, to deal with the debt problem in a piecemeal and unbalanced manner, without confronting its root causes - and thereby further erode the trade and payments system; or, to reform that system so as to avert a rupture between debtors and creditors via a revival of employment in industrialized countries and development in developing countries. From a political standpoint, only the former option appears viable. Yet, the high degree of interdependence in the world economy - both among countries and among the problems of the international monetary, financial and trading systems - makes it imperative to opt for the latter course. There exists, in short, a dangerous disparity between political possibilities and economic necessities.

This paper proposes to draw on and highlight those aspects of the UNCTAD Report's analysis that are of geatest relevance to the debt question.

Amplification of Shocks by Cyclical Commodity Price and Interest Rate Movements

The debt servicing difficulties encountered by certain countries are no doubt partly due to their own policies. For the most part, however, the indebtedness accumulated by developing countries over the last decade stemmed from a series of severe external 'shocks' that came at short intervals - particularly at the end of the 1970s and beginning of the 1980s. The officially held view that the OECD recession would be short, and that interest rates would fall substantially, led many countries to expect their external positions to right themselves quickly, and accordingly to borrow in the interim.

As will be explained below, the origin of the deficits (and of the increased debt service to which they gave rise) must be taken into account in the finding of solutions. But first it is necessary to evaluate the role of the trade and payments system in transmitting the 'shacks'. For a while the disturbances transmitted from developed to developing countries originated largely in the policy choices of the former, the transmission was greatly amplified by certain basic characteristics of the trade and payments system. As in previous recessions, earnings from primary commodities were hit particularly hard because in commodity trade shifts in demand trigger changes in price rather than in quantities supplied. An additional factor depressing commodity prices was destocking induced by the rise in interest rates. Hence the dramatic decline of the terms of trade between commodities and manufactures which took place.

The escalation of interest rates also hit developing countries by raising the cost of their accumulated debt carrying variable interest rates. Debt has thus served as an additional and new channel for the transmission of disturbances, for prior to the I970s developing countries had relatively little floating-interest debt. It is to be stressed that the use of variable interest rates had been a necessary condition for the previous growth of bank lending to developing countries (i.e. of the widely-acclaimed success of recycling through the private capital markets). And yet, it led to the unavoidable result of making the developing countries - and hence the banks - highly vulnerable to monetary policy abroad (in particular the United States). Price instability, which has long been a feature of commodity trade, has therefore become characteristic of the transfer of financial resources as well.

The impact of the recession on the developing countries was therefore severe not only because overall macroeconomic policy in industrialized countries was greatly tightened to secure 'dis-

inflation', but also because of (a) the mix of-policies, involving a heavy reliance on monetary policy (in the context of a shift toward "controlling the monetary aggregates" and leaving interest rates to find their own levels in the market); and (b) the recent evolution of the international financial system ("privatization") involving the rapid expansion of bank lending to developing countries.

Cyclical commodity-price and interest-rate movements have thus worked hand-in-hand to greatly amplify the impact on the developing 'periphery' of shifts in both the overall stance and the mix of policy in the 'metropolitan centres'. A different mode of organizing commodity trade and of providing external financing (and of macroeconomic management) would have greatly reduced the size of the disturbances transmitted.

Pro-Cyclical Bank Lending

Just as the stock of variable interest bank debt has served to amplify the cyclically-induced deterioration of the current-account balance, so the flow of new lending by banks has served to generate shifts in capital account balances in the same direction, thereby accentuating the worsening of overall payments balances. The
collapse of bank lending to a large segment of the developing world that has occured has been largely induced by the worsening of the current account (for the reasons already discussed, and because of lowered demand for exports of manufactures and protectionism, on which more is said below) since that made it difficult for many debtor countries to meet interest payments out of current earnings. But the collapse has also reflected the herd-like behaviour of banks - a behaviour that had been exemplified by syndication which had fuelled the previous rapid expansion of bank lending to developing countries.

Pro-cydhcality in bank lending destabilizes real economic activity. Yet, crises and panics are not untypical of private financial markets. A full-scale and self-destructive stampede has been pievented by the banks' acting together to maintain a certain minimum flow of new lending - not enough, to be sure, to generate a positive net inflow of finance, but enough to make sure the loans keep 'performing'. A leading role has been played in this process by the IMF, which has guided the private financial markets to prevent their inherent fragility from resulting in a disastrous outcome. This has been of benefit not only to thee debtor countries, but also to the banks and the international economy generally.

The tenuous equilibrium which has thus far been successful in warding off an international financial collapse has been achieved not through the free play, of private market forces, but by the visible hand of an international public institution. A reform of sorts has in a sense thus, already taken place. But it constitutes a purely temporary solution. The twin questions of the future role of bank lending and of alternative ways of transferring resources
pose themselves willy-nilly.

Inadequacy of Official Financing

The monetary system, while helping somewhat to soften the blow of a worsened balance-of-payments, has failed to provide sufficient liquidity to allow countries to protect output and investment from being disrupted by deflation abroad. It has thereby given a strongly deflationary bias to the world economy.

This inadequacy is structural. On the one hand, over the years the size of the IMF, in particular of its quota resources, has shrunk relative to other aggregates - a process that has paralleled the privatization of the monetary and financial system. On the other hand, the balance-of-payments adjustment process has continued to be asymmetrical in its treatment of surplus and deficit countries. These two factors have reinforced one another, the upshot being that the IMF now finds that its role now consists largely of 'catalyzing' private financial markets while securing 'adjustment' - i.e. deflation - by the 'deficit countries, the latter being seen as necessary to obtain the former. This may be far removed from what Keynes and the other Founding Fathers had in mind for the IMF; but it is in-keeping with the main lines of evolution of the monetary and financial system since Bretton Woods.

The paucity of finance from-the IMF has been accompanied (and its consequences accentuated) by the relative tightening of longer-term finance available from the World. Bank and other development finance institutions. "Aid fatigue" and a dc-emphasis of official financing even of a non-concessional character have been increasingly in evidence, and this has been part and parcel of the privatization process referred to earlier.

Protectionism

Although tariff liberalization has proceeded far over the last three decades; the GATT-based system has been progressively eroded as countries have increasingly resorted to a variety o£ non-tariff barriers (including 'voluntary' export constrdlnts) that discriminate against 'new-comers'. This protectionist trend has been quickening in recent years, under the double pressure of severe unemployment in developed countries and the intense export efforts of developing countries prompted by financial distress. Thus, the very factors that have made it all the more necessary for the developing countries to export have- (in combination with other more enduring factors) also made it more difficult for them to do so.

A basic long-term problem is perhaps that while there has been a shift towards 'managed' trade, such 'management' has not been for the purpose of attaining international development objectives or contributing to international monetary and financial equilibrium. But it must be recognized, no less, that the malfunctioning of the monetary and financial and commodity system, and the world deflation generally, have placed excessive demands on the trading system. High interest rates, for example, have resulted in misaligned exchange rates among developed countries, financial distress in developing countries, as well as lowered world demand, which have strengthened demands for protection. Financial disequilibria have thus been thrown onto the trading system, and overloaded it. These disequilibria may prove to be temporary; but the consequences for the trading system and for development may prove to be long lived for the reason that import barriers once erected are notoriously difficult to dismantle. To the extent that the problems of the trading system come from outside that system, the solutions also lie outside.

Perverse Adjustments

The lack of a coherent, global adjustment process creates certain pressures towards perverse payments adjustments, i.e., responses which enlarge the deficits. Two such perverse effects deserve special attention: (a) the contraction of trade among developing countries; and (b) the inducement to over-produce primary commodities. The former takes place if each country, in an effort to reduce its imports without giving preference to developing countries, cuts its purchases from such countries: such cuts do not improve the collective balance of developing countries vis-a-vis surplus countries - they simply reduce both exports and imports. The inducement to overproduce primary commodities will arise if each deficit country devlaues its currency in real terms and thereby (or otherwise) makes domestic production more profitable.

Thus, non-discriminatory, "outward-oriented" adjustment processes are pregnant with dangers, and great care needs to be taken to avoid efforts to service debt from destroying markets and thereby increasing the burden of debt ("debt-deflation").

The Deflaionary Feedback

An improvement of the developing countries' collective trade balance that takes the form of a reduced volume of imports and/or an increased volume of exports imposes deflationary pressure on the industrialized countries, since it involves for them either a loss of export orders and/or additional imports not matched by additional exports. The present asymmetric approach towards debt and payments adjustment therefore creates a double pressure on the level of world economic activity. It causes output to fall in developing countries, by reducing the supply of essential imports; and it causes incomes to fall in developed countries by lowering aggregate demand. By contrast, an improvement in the current account of developing countries led by higher commodity prices and lower interest ratess would avoid this deflationary impact. This provides an alternative, growth-oriented process of adjustment.

Recovery

The recovery currently under way in the OECD area is not, however, bringing much adjustment through this second route. For one thing, interest rates remain high because of an asymmetry in the U.S. policy mix over the cycle: tight money was used to achieve disinflation, but there has not been a comparable loosening of monetary policy in order to bring about a recovery of demand, that task being assigned to fiscal policy. For another, the OECD recovery - being largely confined to North America - has not pulled up commodity prices by much, since the principal commodity

importing countries are lagging behind; and the overall pace of recovery is also weak. Moreover, these two factors combined with the damage already inflicted on bank psychology are preventing a recovery of voluntary bank lending. Thus, although the negative consequences of the OECD downturn were amplified, the positive consequences of the upturn are not.

Moreover, the developing countries find themselves obliged to use much of their incremental export receipts to replenish their reserves and deal with arrears, rather than increase imports. Activity levels in developing countries therefore remain depressed, which in turn deprives the industrialized countries of an expansionary feedback. In other words, while the debt problem owes much of its origin to the recession, the debt overhang itself now exerts recessionary pressure.

What is more, the whole system is now even more vulnerable than before to a renewed OECD recession or jump in interest rates, for that would further destabilize the financial system, which would in turn destabilize the world economy. This state of affairs is to the benefit of no one - not even renders.

Towards a Development Consensus

In the present context, the adjustment process inevitably raises certain conflicts of interest. For example, pressures by international financiers and the international monetary and financial agencies on developing countries to redress external imbalances by means of export growth come into conflict with the demands of employers and employees in developed countries for protection against foreign competition. Moreover, in response, in part, to the interests of the export industries of the developed countries, developing countries are increasingly being urged to reduce their own import barriers, notwithstanding the fact that they are at the samee time obliged to cut their imports.

But there are also a number of areas where the interests of the different parties converge. Both the export industries and the import-competing industries in the developed countries have an interest in seeing that the import capacity of developing countries is not harmed by such factors as low commodity-price and lending levels and by high interest rates, and that adequate liquidity is made available to avoid excessive or over-rapid adjustment. The export industries in developed countries and financiers also have a common interest with the developing countries in seeing the Tatter's exports grow over the long-term, and hence in improving the access to foreign markets of developing countries. Profit and wage earners in developed countries, have, in common with developing countries, a stake in ensuring that aggregate demand is not too low and that interest rates are not too high. All parties have an interest in avoidingg a collapse of the international financial system.

These considerations provide objective basis on which to build a "development consensus" which would not only reaffirm the emphasis on employment and growth that underlay the design of the post-war systems, but complete that commitment by recognizing that rapid development in developing countries is imperative both for the developing countries and for the proper functioning of the world economy as a whole.

Awareness of the need for reform of the trade and payments system is unlikely to occur as long as international economic discussions separate from one another the ever more closely connected problems of development, employment, debt, trade and payments balances. One major failing that results is that decisions on the international monetary and financial system, although having a deep impact on the real sectors in both developed and developing countries, are circumscribed by the perspectives of narrow monetary and financial considerations. At the same time, the agenda of international monetary negotiations is being shaped in restricted groups in which developing countries are not represented.

What is required is an alternative approachh which would seek to reform the trade and payments system on the basis of the interdependence of the problems in these fields, and of the mutual dependence off employment in the developed countries and development in the developing countries.

Outstanding Questions

Efforts to implement such an approach would necessarily require governments to grapple with a number of very basic and fund- amental issues. Among the more important of these are the following:

a) How and to what extent is it possible for large countries to take into account the needs of the

system in designing policies? What mechanisms are likely to be required to achieve such centvesnd disiplin s? Would also be necessary to equip the System with new or strengthened mechanisms to offset the international impact of domestic policies of major countries, such as fluctuation in interest rates?
b) What are the mechanisms available to remove the bias of the system against full employment and development? Can features be designed for the system that would encourage national policies contributng to growth and stability?
c) How can the system be made better able to resist the generation of cyclical fluctuations? In the area of payments this raises the question of whether a more symmetrical balnce-of-pay ments adjustment process might be devised in which the distributor Of burden of adjustment between surplus and deficit countries would be arrived at in the light of the overall cyclical situation in the world economy. In the area of trade this raises the question of how the commodity regime can be made more resistant to cyclically-induced swings in price.
d) What is the proper domain of the system as regards its membership? Some socialist countries of Eastern Europe are associated with the mechanisms governing trade and payments among developed market-economy countries as well as with those governing exchange among socialist countries. Is it possible to devise a common framework that would have equal validity for both groups of countries?
e) What is the proper domain of governmental intervention with regard to international transactions? This issue has a number of dimensions. One of the more important is whether international financial transactions should systematically be treated differently from the exchange of goods and services. At present financial transactions counter little, if any, governmental constraint in most major countries; and where constraints do exist, the trend is toward reducing or eliminating them. Trade, on the other hand, is subject to considerable and growing governmental interference, some of which is directly or indirectly the result of exchange rate misalignment made possible by freedom of capital movements. Is there a rationale for such divergent trends? Is there a case for a more balanced approach in which governments would attempt to reach a rough equivalence between policies that impede trade in financial assets and those that impede trade in goods and services?
f) What is the proper domain of the trade regime? How are governments to formulate a common framework of rules that would meet trading needs in manufactures, agricultural products and services? How can this regime provide an adequate framework for intro-firm transactions and take account of the various trading subsystems?
g) How can the international system be endowed with mechanisms that allow necessary adjustment in policies and in national economies to go forward in the context of growth and development? In the sphere of payments, this entails devising mechanisms to support a balance-of-payments adjustment process that is compatible with growth, In flu sphere of trade, it entails devising mechanisms to allow countries to accommodate changes in the competitive capabilities of their trading partners, particulary those newly entering world markets. What is the role of deliberate structural adjustment policies in such a process? Can governments devise safeguard arrangements that are adequate from an international standpoint? How can the trading system be made to meet the needs of weaker trading partners - that is, the developing countries?
h) What is the feasible scope of official action in the monetary sphere? In the past, it was assumed that that governments could have a collective policy as regards the creation of international liquidity and the character of the exchange rate regime. Is the present scope of government influence in these areas sufficient? If not, how can govemments secure its enlargements while ensuring consistency in national policies?
i) How can a reasonably predictable and growing flow of development finance consistent with development needs be secured? Can such flows be made a more integral part of the payments system?
j) What institutional arrangements need to be put in place to ensure through time coherence and consistency in the formulation of policies relating to trade and those relating to payments so that they may promote full employment and development?

Making a Start

Although these fundamental, underlying issues form the core of any age"th for reform, there are a number of immediate and urgent issues that will need to be given special attention. Foremost among them is the question of debt.
A multitude of proposals presently exist with regard to the way in which current debt problem

might be alleviated. One of the more important issues in this regard, however, is the way in which the resolution of present difficulties can be made compatible with high and rising financial flows to debtor countries in future yeas, which is an issue that can only be adequately addressed in the context of a broader discussion of the evolution of the financial system in the years to come. The debt problem is also closely related to the conduct of monetary policies in developed market-economy countries, the growth of activity in those economies and the access of developing countries to foreign markets.

CHAPTER 14

World Debt and World Trade
Sidney Dell

Any lasting improvement in the world debt situation calls for conditions under which export growth in the developing countries exceeds the interest rate that they have to pay on their foreign debt. The larger that differential, the more quickly can the debt problem be brought under control. One could go further and say that a viable world economy would require that export growth rates should be sufficiently high and interest rates sufficiently low to permit the debtor countries not only to service their foreign debt but also to finance a level and rate of growth of imports consistent with adequate domestic growth. If, therefore, we want a viable world economy, a precondition is that interest rates should be brought down while world economic growth is restored to a level that will permit the exports of developing countries to rise in line with the needs for importing and debt servicing.

One can, in fact, easily envisage conditions under which the world debt problem would vanish. As Dornbusch and Fischer have pointed out in a forthcoming paper for the Group of 24, with a sustained 8 percent average real export growth and a 5 percent effective interest rate, the debt problem would disappear. Such assumptions are by no means extreme. They are, in fact, assumptions that could readily have been made during much of the period since World War II. But whether such assumptions can be made now is the crux of the problem. If one takes it for granted that conditions will be such as to make such assumptions possible, one is simply assuming the problem away. It is in this sense that most of the pro. jections now available are little more than wishful thinking - the authors consciously or unconsciously assumed what they set out to prove, particularly that interest rates will ultimately fall well below the export growth rate.

The current wave of optimistic projections is making it less likely rather than more likely that governments will take the steps necessary to create the appropriate conditions for coping with the debt problem. If all is going to be well anyway, why rock the boat with all kinds of policy changes of which Professor Friedman or Professor Laffer or both might disapprove?

The restoration of a healthy world economy depends, in my view, on a more balanced relationship between government policies towards growth on the one hand and inflation on the other, as well as on a willingness to permit monetary policy to operate in a manner consistent with low interest rates. There is no sign of any shift in government policy in these directions, and it is this, more than anything else, that makes me sceptical about the optimistic projections for the world debt outlook.

As far as interest rates are concerned, the fashionable view is that the present high level is mainly if not wholly due to the United States budget deficit. This view is, however, a drastic oversimplification off reality. Thus far, the.United States budget deficit has provided the motive power for a recovery of the economy, leading to higher incomes and therefore savings. There is no evidence at all that at present levels of employment and economic activity in the United States the Government is crowding-out private investment. Obviously such a crowding-out effect is possible if the United States reaches full employment, but it is quite uncertain that the economy will in fact be permitted to go that far. There appear to be factors other than the budget deficit that are keeping interest rates up in the United States, particularly the monetary policy that is being pursued in the effort to head off any possible recurrence of serious inflation.

One should, however, note in reference to this point that a reduction in the United States budget deficit at current levels of activity and employment would not only relieve pressure on the demand for savings, but would also cause a slowdown in the economy. Thus, any possible impact of a fall in government demand for savings on interest rates could well be offset - from the standpoint of foreign debtors - by a slowdown in United Stated demand for their exports. This dilemma can be avoided only if the governments of industrial countries are prepared to allow their

economies to attain a higher level of business activity and employment than has been the case during the past decade. This in turn will call for greater efforts to counter inflation through the achievement of social consensus on income distribution, and a lesser inclination to resort to monetary restriction for this purpose.

Let us leave aside for the moment the point that it is contrary to any rational view of the matter that developing countries should be running trade surpluses with the developed countries. The dis- tortion of both political and economic priorities involved in the current net flow of real resources from low-income to high-income countries is too obvious to need stressing in this company.

With all due allowance for the irrationality of the situation, the question arises whether a powerful export drive in the Third World could bring long-run benefits that would temper the adverse effects of the current situation and ultimately ease the pain associated with current retrenchment. For those countries able to engage in such a drive and to attain a position of being able to overcome the foreign exchange constraint that results from an over-specialized export sector, future problems of development would be greatly eased. The history of the Japanese economy and more recently of the economy of the Republic of Korea are excellent examples of what can be achieved along these lines.

Unfortunately, these good things are not as easily attained as they may seem to be, and some of the pronouncements often made about the export potential of developing countries, given appropriate exchange rates, ignore certain basic facts.

One basic fact, of course, is that for the great majority of developing countries, especially among the lower income group, the diversification of exports still lies in the future. Many of them still rely on very few primary commodities for their export earnings, and these commodities have the unfortunate property that a general export drive by all countries may merely lower the export revenue realized by every one of them. Those who advocate drastic devalu
ations as the magic solution to the problems of countries with non diversified export sectors are doing little service to the countries concerned, except where domestic inflation has pushed local costs to the point at which it does not pay the primary producer to export at all. Even on the import side, the shortage of foreign exchange in such countries is usually so acute that devaluations alone will not bring about the reductions in imports that are required. It also seems unrealistic on the part of the World Bank authors of World Development Report 1984 to deplore the resort to direct
controls by countries faced with pressures on their balances-of payments of the magnitude now experienced in the low-income countries. On page 44 of that report the authors write that:

"There is a difference between reducing imports by reducing domestic spending - painful though that is - and reducing imports by imposing direct restrictions on imports. The latter is likely not even to produce the needed external surplus. The resulting rise in protection introduces a further bias against exports but does not do anything to cut spending in relation to output, as is required. Most of the major debtors have, unfortunately, adopted this second method of reducing imports".

This kind of argument may be worthy of consideration under conditions in which there is substantial elasticity in the economy and the basic needs of the population can be met within available resources. But that is hardly the case today in many of the developing countries where per capita incomes have been falling for a number of years and especially in those cases where drought and other unfavourable factors have led to sheer starvation in many areas. It shows remarkable insensitivity to tell governments faced with such problems that they are violating the principles of the market economy by deciding to concentrate their limited foreign exchange resources on the import of foodstuffs and other goods essential for the basic needs of the population rather than on luxury consumer goods. At currently depressed levels of income and acute shortage of foreign exchange, the further declines in income required to generate reductions in imports on the scale required may in many cases be completely unacceptable politically, as well as inefficient in economic terms.

Let us now consider the countries that have already achieved a certain diversification of exports: it is among these countries that some of the largest amounts of foreign debt have been contracted. Here the opportunities for expansion and further diversification of exports are manifest, and indeed the recent recovery in the industrial countries, notably the United States, has already permitted some countries to record new export successes. But we encounter an obstacle of a different kind, namely the upsurge in protectionism in the countries that constitute the principal markets. Moreover, Dr. Avramovic has now suggested that the recent decline in export prices of manufactures exported by developing countries may well signify that even in that sector competitive devaluation may be depriving developing countries of at least part of the fruits of

their export gains, though here the price elasticities are probably more favourable than in the case of primary commodity exports.
Several of the industrial countries are seeking to exact a price for slowing down or reversing the growth of protectionism by insisting on the liberalization of imports in the developing countries. In an important article in "Foreign Affairs" Mr. William Brock has stated that "the need for high-debt countries to increase exports, while curtailing non-essential imports creates strain in the international trading system. Industrialized countries, which feel they are losing export markets while being forced to absorb more imports fall prey to calls for increased protectionism". And he goes on to say that "trade liberalization can no longer be one-way; it must be reciprocal. The need exists for industrial countries to liberalize their markets and to rationalize their less competitive sectors. However, our ability to do so will be lessened considerably if developing countries do not join in a good faith effort to undertake appropriate reforms'.
This is a quite understandable negotiating position that deserves a reasoned answer. First of all, we might ask this: would a liberalization of import controls by Brazil, Mexico and other debtors lead to an overall-expansion of their imports? This hardly seems likely at the present time. These countries need no persuading that their imports are too low, but their capacity to import is rigidly limited by the relationship between interest rates and export growth already mentioned together with the constraints on new borrowing. Thus a liberalization of imports can shift the composition of imports from more essential to less essential goods, but is unlikely to affect the total value of imports. As far as the exports of debtor countries are concerned, there is aa curious internal contradiction in creditor country policies. They want the debtor countries to meet their financial obligations, but they are reluctant to face the trade implications of that objective.
The banking and financial communities within the creditor countries want the debtor countries to cut back their levels of income so as to reduce imports and free resources for the expansion of exports, thereby permitting them to earn a surplus of foreign exchange with which to discharge their debt service obligations. The domestic producers in the creditor countries, on the other hand, have precisely the opposite objectives - they would like to see the developing countries import more, and export less - particularly where the latter countries' exports compete effectively with home production (for which the remedy, as they see it, is additional protective trade barriers). Mr. Brock reports that the Mexican debt crisis alone resulted in a loss of about 240,000 jobs for the United States, Mexico having been forced to make drastic cuts in imports of goods from the United States so as to permit payment of interest on foreign debts.
These considerations lead us to the following questions: Are the creditor countries prepared to make room for additional exports from the Third World by reducing interest rates, and hence the proportion of Third World export earnings preempted for interest payments? If not, how will we avoid piling up more and more international indebtedness, while the exports of the debtors chase interest rates and the world economy as a whole relapses back into stagflation or worse?

CHAPTER 15

Debt, Adjustment and Development: The Lingering Crisis

Gustav Ranis

Our financial pages fully reflect the current confusion: one week we are told that the international financial system has finally weathered the storm of third world indebtedness which first descended on us in the fall of 1982, the next we are asked to gird our loins for imminent joint or individual defaults by some of the most severely affected LDCs - requiring a write-down of billions of commercial bank assets, and worse in terms of the prospects for world trade and growth; one week the incipient world recovery is hailed as the panacea, the next it is all a question of whether or not LDCs can "put their houses in order"; one week the problem is described in terms of a lack of short-term liquidity, the next as matters of long-term insolvency. And most recently, to top it all, we have experienced a new phenomenon, the Argentine rescue operation, at lower rates of interest, with other LDCs participating.
Where do the facts lie? What does analysis, rather than instinct, tell us? And, most importantly, where do we go from here? These are the questions I would like to briefly address.
As to the facts, there can be little doubt that the international trading and financial community,

especially the middle income countries or the NICs, has been exposed to a series of rather severe blows since 1973. These include two oil shocks, the first in 1973, the second in 1979, a general rise in interest rates on outstanding debt after 1981, followed by global recession and the exhaustion of OPEC surpluses, and, throughout, a still modest but nevertheless noticeable protectionist trend. Third world debt, much of it incurred in the 70s with the help of recycled petro-dollars, now amounts to more than U8= 800 billion, with dose to 30 countries currently in difficulty by virtually any debt servicing criterion.

The recovery currently under way is not likely to refloat all the ship., partly because it is highly unlikely to bring us back to the halcyon days of 1950-73, but mainly because, even ifit did, the structral conditions of the ships is not upto the task. In brief, the levels of income and export growth required to get us back to those jhpae "good old days" will not occur simply as a consequence of a brighter international environment. This conclusion is based on the fact that the current problems in many of the Latin American, Asian and some of the African countries did not start in 1973; they were there earlier, below the surface, masked by the unusually brilliant early post-war performance of the world economy, and exacerbated since.

The fact is that everyone has had to adjust to the unfortunate events of the past decade- But what has gone relatively unnoticed is that, while the majority adjusted by increased borrowing and is now being forced to cut imports as part of IME-orchestrated rescue operations, a minority, mostly in East Asia, adjusted mainly by capturing a larger share of a shrinking global market for non-traditional exports. This differential capacity to respond to the same multiple blows was the result of choosing a different growth path as early as the mid and late 60s.

While the East Asian NICs are typically much smaller economies than the Latin American and Asian NICs, what is noteworthy is the marked difference in the extent of fundamental structural change that can be observed long before 1973. For example, Taiwan's export orientation ratio (exports/GDP) rose from 10 percent in 1950 to 30 percent in 1970, while that of the Philippines increased from 13 percent to 19 percent over the same period, and Mexico's actually declined from 17 percent to 8 percent. Even more telling is the change in the composition of such exports: in Taiwan 79 percent of exports consisted of manufactured goods (41 percent of which were the products of light industry) as against 6 percent in the Philippines (of which only 9 percent were in light industry) by 1970. In other words, while the handful of East Asian NICs shifted from the production of basically non-durable consumer goods for domestic markets in the 50s to the competitive export of these same commodities in the 60s, prior to shifting to a more capital and technology-intensive product mix since, the vast majority of NICs moved directly into the production for internal markets plus some subsidized exports of the more sophisticated and capital-intensive range of industrial products.

When we examine the performance record of the post 1973 era in a similar comparative vein, we are again struck by the large differences - in growth rates (higher in East Asia), in debt burdens (lower in East Asia), and in rates of inflation (lower in East Asia). These are not random accidents of history. Rather, the East Asians were, in fact, more capable of adjusting to adversity, by capturing an increased share of export markets in labor-intensive manufactured goods. eanwhile, the Latin Americans tried to maintain their growth rates by resortingg to massive commercial borrowing until that ran out by 1982 and only IMF belt-tightening programs were left as an answer.

Nor can the relatively better performance over the past decade in East Asia be placed at the doorstep of a differentially less punitive international environment. Everyone faced similar reductions in international demand, in the terms of trade, in increased rates of inflation, and, later, in higher rates of interest, along with increased protectionism on the part of beleaguered advanced countries. In fact, it would be fair to say that the East Asians appeared considerably more vulnerable, given their generally greater natural resource scarcity and almost total dependence on imported oil, and given the resistance of rich countries, by means of quotas and the like, aimed at the successful super-exporters.

What permitted the East Asians to successfully overcome increased adversity was, in fact, their earlier shift in policies towards export orientation as well as sustained mobilization of the rural economy. This was achieved, gradually and haltingly, with a cone siderable number of twists and turns, shifting from direct to indirect controls and marked, generally, by an increased willingness of governments to work through the market instead of attempting to replace it. The changes recorded include sustained moves towards greater import liberalization, more realistic exchange rates, less repressed financial markets, and less of an urban industrial bias.

As a consequence, not only did thesee systems achieve a superior performance with respect to growth, employment, and equity, but they were also much better able to respond to the exogenous

shocks of the past decade. Broader participation and entrepreneurial maturation connote a greater ability to "roll with the punches," shift output and export specifications in response to protective quotas, find new trading partners, new commodities and generally adjust flexibly to adversity. It is thus no accident that the most severe and intractable debt problems have been concentrated among the Latin American countries, in the Philippines and in one or two countries of Africa. While East Asia switched towards a greater deployment of her human and entrepreneurial resources, elsewhere the continued reliance on a more abundant natural resources base, supplemented by foreign capital inflows, permitted countries to continue financing an increasingly protected and inefficient development path. Once the fuel ran out, all this rendered these economies ultimately incapable of a flexible response.

Of course, every East Asian NIC has not done equally well, either in the extent or consistency of direction of its policy reforms, nor has every Latin American or ASEAN NIC consistently failed to move in these directions, at least partially and for a time. In fact, one would be hard put to distinguish between South Korea and Colombia in the late 70s on these counts. The only point we really need to make is that the NIC world has experienced substantial diversity in policy choice and development experience in the past - a feature which has given rise to widely differing adjustment capacities and performance. It is this point which is crucial to the considerations for policy which follow.

What is the view from the most heavily indebted countries of the South? The picture is mixed. As we would expect, there is much emphasis on the need for more liquidity, greater market access, plus the occasional call for debt relief or the formation of debtor cartels. One also hears - especially in the Southern Cone of Latin America - recently the victims of rather extreme and internally flawed versions of Chicago School policy packages - calls for a new retreat into protectionism and domestic market orientation - hardly conducive to ever working one's way out of debt. There are those who continue to be export elasticity pessimists on an individual country basis and those, more sophisticated, who fall back on the fallacy of composition argument, i.e, how can all LDCs be simultaneously successful in increasing their non-traditional exports. But there are also other voices, even in such unlikely places as the U.N's Economic Commission for Latin America, which are beginning to accept the above analysis, at least in its general contours. They, rightly, insist that no general prescription makes sense and that every country situation is different and needs to be differently addressed. But all agree that the present level of discourse as well as the present mechanisms For action - on liquidity, on conditionality and on development itself - are not adequate to the task- Let me proceed first to a characterization of that situation - and then to a modest proposal of how we might go about improving it while there is still time.

At present the international community, led mainly by the IMP, but sometimes by the Federal Reserve Board of the U.S. and the U.S. Treasury (as in the case of Mexico in 1982 and Argentina most recently) is engaged in country-by-country negotiation on debt rescheduling with a substantial number of severely affected, mostly middle income, countries. These are basically short-term exercises with a one or two year time frame. The IMF typically persuades the commercial banks to roll over their loans while exacting time-phased performance promises - mainly with respect to monetary and fiscal targets, exchange rate adjustment, and decline in inflation from the recipients. Each of the other actors, the creditors of the Paris Club, the bilateral aid donors and the multilateral banks are only indirectly involved.

The World Bank, for example, might well have ideas about longer-term structural changes that are relevant, but that is likely to be a different ball game usually proceeding quite separately under its own stylized rules. In arriving at an IMF package the discussion centers typically on issues of more short-term liquidity, desired by the recipient, versus more short-term austerity, desired by the Fund. Meanwhile, each recipient remains constantly exposed to a multiplicity of bilateral and multilateral aid missions, each asking similar questions of the same busy economists and policy makers and insisting on their own conditions to satisfy their own national constituencies. And the commercial banks, anxious to avoid IMF interference in the 7-Os, are now insisting on the IMF umbrella and having their anus twisted to maintain and/or increase their exposure in return.

There should thus be little surprise at the rapidly increasing levels of fatigue, mutual irritation, and cynicism in evidence as many of these contacts have become increasingly stylized,, lacking both credibility and substance. In this environment,, it has become a question of hammering out agreements to buy time, without any clear specification as to the use to which that extra time will be put. And thus we are lurching from crisis to crisis, quarter by quarter, fundamentally unsure as to whether the basic debt problem is indeed being solved or simply postponed.

In my view a much improved method of carrying on the entire business of capital flows and policy review is required. It is possible to work towards a more arm's length relationship from

some of the most powerful donor agencies as well as one that is capable of generating the requisite freshness, intellectual independence and policymaker attention in both rich and poor countries. That issue is basically not simply one of more liquidity versus more austerity but of the appropriate use of temporarily larger levels of liquidity to effect the longer-term structural changes agreed upon by all the parties, especially, of course, the recipient country. With a large spectrum of international creditors and donors involved, running from commercial to investment banks to bilateral donors, multilateral donors, the IMF and the World Bank, all dealing with the same country and all presumably with the same interest in improving its longer-term adjustment capacity, the present patchwork arrangements are just not upto the task. Foreign capital inflows without proper adjustments can, as we have noted, make it possible to avoid reform; but it can also, and should, help render reform possible if there is prior agreement at the technical level by all the parties concerned. In fact, conditionality can only work if there is such general ex ante agreement all around on the merits of any restrncturing package.
We need to place the discussion of desirable and feasible in dividual country adjustment paths, alongwith the complementary role of foreign capital and conditionality, on a different plane, less confrontational, more long-term and more multilateral in the true sense of that term. It makes no sense to have the Paris Club concern itself exclusively with official (or officially guaranteed) debt, commercial debt assigned to IMF cajoling in relation to negotiated standbys, with regional and World Bank lendings as well as bilateral ODA negotiations kept quite separate - all until a crisis drives everyone under the same (usually IMF or the U.S. Treasury) roof. All the parties concerned with country X's situation and economic health must find a way to come to agree with each other and with the country in question, as well as with other "neighbouring" LDCs, on the situation, the prospects and the actions required, in a non paternalistic and truly multilateral setting. The allocation of Marshall Plan funds to individual European countries in the early post-war era is perhaps the closest analogy to what we have in mind. NICs would be asked to sit in judgement on each other as well as on the stance taken by donor/creditor agencies.
The recent Argentinian bridging operation in which Mexico, Brazil, Colombia, and Venezuela participated along with the U.S., is perhaps more than a straw in the wind - but with the important difference that this was part of a 30 to 90 day bridging operation while we are concerned with the need for a three to five-year real long-term structural adjustment package. In fact, while we agree that we have to be willing to keep putting our fingers in the dike whenever a leak occurs, the real challenge facing the international community is to address these longer-term issues. In short, it is not a question of more liquidity versus more conditionality over a two year standby period, but how to obtain an assured long-term change in structure in connection with a larger volume of liquidity on a negotiated, country-by-country basis.
Meaningful policy change, of course, takes time as well as additional resources. Moreover, the donor/creditor community has an obligation to ensure that the additional resources are indeed used to "bind the wounds" of those affected by policy changes rather than to permit business as usual to continue until "something turns up". One must also recognize that new ways of negotiating country package of basic structural adjustment together with foreign capital ballooning are not easily devised or cheaply implemented. I would thus recommend moving cautiously, perhaps initially only with one, or at most two, of the most seriously affected countries over the coming year - while we continue our finger-in-the-dike operations elsewhere. If the new system works it will find its own adherents.

Specifically, I would propose the following:
1) A necessary first step is to try to reach broad agreement on what country X's current situation is, its problems, and its capacity/ willingness to effect meaningful policy change over a three to five year period. This would clearly not be an easy task but, as imperfect as the science of development economics is, it is not impossible to arrive at a joint assessment of what is technically and politically feasible with the help of specified additional inputs from abroad. In the absence of such agreement, especially on the part of affected interest groups within the LDCs, no amount of conditionality, incentive-programming or arm-twisting would make much sense. We are all too ready to ask others to understand our congressional and pressure group problems while remaining rather insensitive to the domestic political problems of debtor LDCs. This has been amply demonstrated in recent moths, including in the case of the need to repeatedly renegotiate, the IMF/Brazil rescheduling package.
2) An important feature of the new process would be the involvement of country X's LDC "neighbors" in the process. We have recently seen, in the case of the Argentine interest payments crisis, that such cooperation among Latin American fellow debtors is possible, and in their mutual

interest. Undoubtedly, it was Mexico which "blinked" and came up with an innovative idea because she realized the obvious consequences for all of Latin America of an Argentinian default. It would be even more meaningful if such true multilateralism were pursued in relation to the negotiating and carrying out of long-term structural adjustment package rather than 90-day bridging loans. The way in which Marshall Plan funds were allocated and their use conditioned among the European members of the OEEC is but one regional model which can serve as a point of departure. Agreements based on the multilateralization of resource flows and conditionality should be more politically sensitive in their construction as well as more politically acceptable in their execution.

8) The process of reaching the necessary intellectual and policy consensus among all the parties should probably be carried on as much at arm's length as possible from the most powerful donor/creditor agencies. This is partly because of the deep-seated institutional and possibly ideological hang-ups of some agencies - at least as commonly perceived by the South - and partly because of the possible conflict between independent analysis and the "need to lend". One of our major problems in this whole field has been a marked loss of freshness and intellectual candor and an equally marked increase in mutual fatigue and irritation surrounding the heavily stylized and substantially spurious way in which we currently choose to transact our business. The IMF has a mandate which, at least at present, is too short-run and balance-of-payments oriented. It has been forced to retreat from its longer-term Extended Facilities approach of a few years ago by a combination of resource scarcity and the U.S. opposition. The World Bank, meanwhile, seeing its traditional projects approach becoming increasingly irrelevant to the world of the SOs, is similarly prevented from a large-scale increase in its Structural Adjustment and program lending activities. This is quite aside from an image problem which casts it as ideologically committed to particular policy packages in its advisory role, while continuously anxious to keep lending and maintain country targets in its banking role.

4) The format I would propose, instead, approaches in some respect the Pearson Commission's World Development Council, but focussed at the country, not the global, level. A team of independent experts, drawing on the substantial

and expertise of the Fund, Bank and other agencies as well as the country, own and other LCD exports,would carry out such an assessment at rare intervals, Such a team would have a quasi-independent status, be financed, say, out by a CGIAR type of consultativegroup or some of the scandinavian Countries, and report to a strengthened Development Committee or some other existing in-sitiution perceived as neither a poor man’s nor donor;club. We would, of course, individual donor/creditor institutions, multilateral as well as bilateral, to reserve their individual right to agreer or disagree with the findings of any such assessment as well as the dependent right to decide whether or not to support any n year program that is evolved in this fashion. But, at a minimum even if some decided on a wholly independent course of course of action, we would not be a worse off than we are today, and the exisence of a high quality basic review , at least politically pre-endooresed in general teens all the major parties would provide an important point of departure for reaching negotiated agreements involving all the actors concerned

5) An important ingredient of any such arrangement would clearly have to be its credibility, The donor/creditor community must therefore be willing to take a multi-year commitment stance just as they are asking recipients to make fundamental change whose impact is absorbed only over time We all know that bilater; donors' annual commitment cycles are unproductive from the of view of the very parliaments which enforce them; multiklaterls often submit to quite Voluntarily with similar results; and, worst of all,the IMF has receded from its willingness to experiment with longer-tenn "beyond stabilization only" arrangement. The need to “impose” tough conditioality in one season and then to force-feed sbun tough or renegoti y in ne o intent six months later accompliyhes no productive p the letter of intent six months later accomplishes no productive purpose; worse, it undermines the credibility of the entire process.

What the developing countrieses badly need is the minimal assurance of continuity , given the malti-year balance-of- payment budgetary and political pressures arising in the course of any really serious reform effort.

We do have enough historical cases, e.g. Pakistan and Taiwan in the early, and Colombia and Korea in the mid 60s, to demonsimte the potential for foreign capital ballooning in relation to get-term policy commitrnents on the recipients' prat. But we also have counter-examples - such as India in 1966 when multLyear aid expectations tied to a substantial reform pachge were left to twist in the winds of donor political reassessment - or such as in Brazil in 1988 when some short-term austerity commitments were seen to be unrealistic in the light of the political situation on the streets of Sao Paulo.

6) If the proposed process is to be really credible, it is essential that donor/creditors be willing not only to make additional resources available in connection with agreed-on structural adjustment agreements but also to take a passive stance if such an agreement is not reached. In such a case there would be little to lose since we could always fall back on conducting our business as we do now, i.e. basically buying time. On the other hand, all parties would stand much to gain whenever a program is indeed agreed upon and successfully brought to a conclusion. The positive demonstration effects of such success would be substantial- just as substantial as the negative demonstration effects of some current negotiations. Once an agreed upon, say 8-5 year, program had been completed the foreign resources inflow into country X would return to "normal". Although the need for major structural reform may not indeed recur, there would be no bar to another negotiated package some years down the road, if necessary and appropriate, and following essentially the same procedure. Depending on the country's stage of development and proximity to "graduation", it is just as likely that there would be no need for further specially negotiated exercises.
7) There is no doubt that additional resources may well be required - perhaps via additional IMF quota increases or possibly a new SDR allocation - if we are to be in a position to really assist the substantial number of LDGs currently in difficulty to work their way out of trouble. It is, however, almost certain that the total additional liquidity requirements would ultimately be lower than under the alternative of continuing with current rescue operatic rs. But it would be a mistake, in my judgement, to be concerned too much with the resources constraint at this point. The inter-dependence between rich country banks and poor country debts - especially those with economic and/or political clout - is being increasingly recognized these days. If politicians can be shown that there is a way out - in multilateral country-focussed rather than global negotiations - the necessary resources will become available. Moreover, temporarily larger resources deployed to address basic structural imbalances, i.e. to get LDCs onto a balanced, fully participatory growth and export path, are likely to add up to much less than those needed to continue business as usual, i.e. buying time in the hope that recovery will take care of the underlying problem.

Part IV
Toward a Saner Financial System

even"This breakdown (of the development process) has been brought about by our failuree to manage international financial and monetary' le reco by the ""~ll ngness of some key parties concerned
face." graze the need for some managemrnt of the problems we Kurt Waldheim

CHAPTER 16

A Practical Debt Strategy

Mahbub ul Haq

Reviewing the current international economic scene, it is tempting to slide into a luxurious defeatism and to sound the final alarm. It takes a good deal of courage to remain calm and constructive in a general mood of mass hysteria.
Of course, no one can review the current scene without rising concern. When we lift our eyes from individual events and specific crises, a disturbing trend is increasingly clear. It lies in an erosion of confidence in our collective ability to find solutions for our international problems; a gradual retreat from that previously fashionable but now dreaded word "internationalism"; a slow turning away from the spirit of the mid-1940s. Franldy, if the underlying currents were in our favour, I would have worried a little less about the individual waves. But we seem to be turning away from multilateralism to bilateralism; we appear to be losing that promising spirit which gave birth to the United Nations and the Bretton Woods. This is a cause for regret but certainly no time for rhetoric. If anything, this is a time for a quiet soul-searching since such profound changes in the international mood cannot be traced merely to the folly of a single nation or a single leader.
Nowhere is the need for this quiet soul-searching more obvious than in the present disorganized chase for some viable proposals for the mounting debt problems of the developing countries. What should have required a collective international approach has been left - with some

reluctance and many prayers - to the mercy of isolated, ad hoc devices, it is as if we were afraid of our own collective capacity to address this problem. Surely, our founding fathers 40 years ago would have least expected that when an international problem of such a serious magnitude arose, we shall aft be found trembling on the brink.

I intend to focus on the debt problem in this article. This is not because I regard this as the most serious threat to the stability of our international fabric. It is, in fact, for two specific reasons. First, the debt problem is a symptom, not a cause, of international irrationality - an irrationality that is manifest in restricted world trade, high interest rates and declining capital transfers at a time when exactly the opposite policies are needed for world economic recovery. When we address the debt problem, it becomes possible to address a number of other fundamental issues with which it is closely linked. Second, humanity responds generally to a sense of crisis. In many ways, the debt issue offers us an opportunity to open some new windows of international understanding, to demonstrate once again that all nations can gain from a collective approach to restoring the economic health of some of its ailing members.

Some Common Fallacies

I believe that a calm and professional approachh to the debt problem must avoid some common fallacies:

We must avoid the fallacy that the current debt problem reflects the irresponsibility of some major indebted nations. We must remember that only a few years ago, Mr. McNamara applauded the same nations for their courageous borrowing and for their successful recycling of petro-dollars, which contributed to a higher growth rate of the world economy. We must remember that as late as 1981, many of these nations were upheld by the international financial institutions as the very model of economic management, precisely at a time when they had already accumulated vast debts. We must finally remember that the fragile international banking edifice rests today on the responsibility, not the irresponsibility, of indebted nations which have preferred to pay their bills - often with trembling hands and with silent prayers - despite fallingg real wages and rising domestic discontent. If we must find a scapegoat - though the very exercise is useless - it must be found as much in the deep world recession, reduced petro-dollars, rising interest rates and greater trade protectionism as in domestic mismanagement.

We must avoid the fallacy that many indebted nations are insolvent. They are merely illiquid. Their development potential is still enormous. Their unsold wheat or cotton or meat or manufactured goods can be converted into repayable foreign exchange both through widening world markets and through counter-trade. The eventual solution lies in exploiting their development potential, not in frustrating it. And let us not forget that it is only through non-action or wrong action or indifferent actionn that we can convert the illiquidity of the indebted nations into insolvency. We must avoid the fallacy that present debt renegotiations, which essentially postpone payments of interest and principal while the debt continues to accumulate, are a lasting correction of the basic imbalance. Total external debt liabilities of developing countries (including short-term debt and credits from the IMP) amounted to US$ 810 billion in 1983, up from US$ 766 billion in the previous year. By recycling debt, essentially on short-leash basis, some time is definitely being bought - and this time may prove valuable - but no permanent solution is being provided. We must avoid the fallacy that the debt problem requires only a financial response. It requires a developmental response. It is linked with restricted world trade market: over one-half of world trade is subject to some form of non-tariff barriers. It is linked with the net transfer of medium- and long-tern lending from private sources to developing countries which fell dramatically from US$ 16 billion in 1981 to minus US$ 21 billion in 1983, or a violent swing of US$ 37 billion in just two years. It is linked with high interest rates on floating debt which raised the coat of annual debt service by over US$ 4 billion between February and May of 1984 alone. It is linked with declining official assistance: for instance, IBRD disbursed US$ 12 billion in 1983 to achieve a net transfer of only US$ 1 billion while IDA-7 has been replenished at a lower real level than in the past. It is also linked with development restructuring in the indebted nation which should ideally reflect lower imported consumption but higher levels of future development activity. In short, any debt renegotiation is only the beginning of a process which must be backed up by complementary policies in trade, resource transfers and investment planning.

We must avoid the fallacy that the current debt crisis can be resolved either exclusively through a case-by-case approach or primarily through a collective approach. An adequate solution will combine elements of both. A case-by-case approach is needed to address the unique problems of each country- But this neither precludes nor would it be successful unless there is a collective

approach to easing trade protectionism, reversing declining trends of resource transfers, strengthening the financial resource base of the IMP and enforcing a more responsible code of ethics on future commercial bank lending. Let us frankly recognize that the case-by-case approach is a carryover from the days when debt problems could largely be regarded as an aberration arising from the behaviour of an individual country. It has the advantage of familiarity with techniques which have been applied in the past. However, the debt problem covering a number of large debtors at the same time is an unusual and a new phenomenon. It requires evolution of general guidelines for debt rescheduling which would give cohesion and consistency to the case-by-case approach. Let me also say candidly that those who are currently polarizing the entire discussion between the stark alternatives of a case-by-case or a collective approach are rendering no real service to the practical problem we face. We must avoid the fallacy that costs of adjustment should be borne entirely by the indebted nations. There could never have been any overborrowing by these countries unless there was overlending by the banks. Any financial transaction requires delicate judgements by both sides. It is the collective judgement of the world community that has been proved wrong by unforeseen developments - particularly by a deep world recession and a reduced supply of petro-dollars for recycling. Moreover, the industrial nations are already bearing some involuntary costs of adjustment. Imports of developing countries - mostly of indebted nations - weree forced to be cut down from US$ 85 billion in 1982 to US$ 48 billion in 1988, thereby imposing a heavy penalty not only on themselves but on industrial countries which rely on exporting 28 percent of their total exports and 6 percent of their national income to developing countries. This continuing penalty could only be worsened by s banking crisis. It is preferable by far to share voluntarily the costs of adjustments of an agreed solution than to bear involuntarily the costs of adjustments of a continuing problem.
- Finally, we must avoid the fallacy that the solutions to the debt problem will be costless or that they can come out of adroit international gimmickery. The costs will be heavy for permanent solutions, though heavier still for lingering non-solutions. It is because of these costs and reluctance over their sharing that permanent solutions have eluded us so far: There is, in fact, no dearth of thoughtful proposals. The proposals advanced by Peter Kenen, Felix Rohatyn, -Charles Schemer, William Cline, Dragoslav Avramovic and several others have some common and overlapping features. They would stretch out maturity dates of short-term loans. They would reduce future interest costs to developing countries by imposing a once-for-all penalty (10 percent under the Kenen Plan) on commercial lenders. They would limit future interest payments by developing countries to a defined percentage of their total export earnings (generally a ceiling of 25 percent). They rely on intermediation through an IMF with augmented resources or through an entirely new institution. The reason why so many good proposals remain unimplemented so far is not because of what they contain but what they omit. They generally omit a proper sharing of costs. They show little concern with new lending, in their preoccupation with rolling over old lending. They are not entirely convincing on additional sources of funds for their preferred intermediaries. They are not generally linked to broader trade, resource transfer and development policies in then anxiety to seek a purely financial solution. And they have unfortunately got mired in the sterile debate over country-by-country approach vs. sweeping reforms. However, I believe that, despite some shortcomings, they provide many essential blocs for an eventual solution -blocs on which we must build and build constructively and expeditiously.

Essential Elements in a Solution

Let us first identify the essential elements in an acceptable solution. They are principally three;
First, in terns of accounting, the commercial lenders should not be made to appear carrying the risk of present illiquidity or potential insolvency. It is not important that they are paid back immediately - but they must have the assurance of getting back what is due to them, when and if they need the funds. In fact, such an institutional assurance is enough for them to leave the funds where they are.
Second; the developing country debtors can only pay in reality what their trade surpluses allow them to pay. Their surpluses would be the reverse of the deficits of the industrial nations. But these large trade surpluses of the developing countries are neither possible nor desirable over the long-run. They would also require adjustments not only by these developing countries but by the industrial nations in their trading patterns for otherwise the circle cannot close.
Third, the difference between the first and the second element must be bridged through an institutional advance - an intermediary which is willing to lengthen maturities to make the immediate servicing of debt manageable, to provide extra liquidity to the creditors against lengthened maturitieg so as to build trust in the financial markets and to ensure that the domestic

economic management in the debtor countries continues to guarantee that the problem of illiquidity is overcome in due course without degenerating into a problem of insolvency.
From these three elements, let us try to put together a viable institutional solution.

An IMF Debt Refinancing Subsidiary

I believe that a constructive search for an institutional solution must begin with the selection of an intermediary. The logical choice is the IMF or a subsidiary of IMP. This is not for any infatuation with the role that the IMF has been playing recently in debt negotiations in Latin American though I must frankly state my conviction that the IMF is often being criticised not for the constraints its staff or management desire but for those imposed on it by its original charter or by its dominant members. My reasons for advancing the selection of the IMF are clearly practical. The Fund is already in this business; it will have less difficulty in winning a new mandate from powerful creditors than any new organization; it can negotiate additional resources more easily than any alternative we can think of, including the possibility of a special SDR issue. Thus, the search for new institutions like a Debt Discount Corporation proposed by Kenen or a worldwide Municipal Assistance Corporation proposed by Rohatyn - while useful as a pressure point - may not be very rewarding when consensus is likely to be reached more quickly on a modified role for the IMP.
But I would like to advance a step further. It is not fair to burden the normal machinery of the IMF with this additional and awesome task without creating a special window or even a subsidiary with its clearly defined mandate. We are dealing here with a widespread, long-term problem with its several links with the policies of the indebted nations as well as of the international community, with major additional costs requiting additional resources and more equitable sharing of adjustment burdens. It requires a special approach with expertise in debt problems. It may even require a different cast of characters on the IMF Board, reflecting the interests of commercial lenders as well as of official debtors and creditors. It would certainly require more day to day coordination with the World Bank, UNCTAD, GATT and other institutions which are the part custodians of the related policies in development, resource transfer and trade fields which must also becopre essential ingredients in any viable solution. In fact, a joint subsidiary of IMF and World Bank may be even more appropriate so that there is a proper blend of short-term financial issues and long-term developmental considerations. It is for these reasons that I am persuaded that the time has come for the establishment of an IMF Debt Refinancing Subsidiary for the credit-worthy, middle-income countries - much the same way that IDA had to be established in the World Bank in 1960 to look after the interests of the poorest, less credit-worthy nations.
Such an IMF subsidiary may have to be funded by a special SDR issue. A smooth resolution of the debt crisis requires more world liquidity, in one form or another. This can be created by additional SDR allocations in the Fourth Basic Period which should be in two parts:
(a) direct allocations to countries which should be used substantially to improve reserves or reduction of debt; and
(b) a part to be allocated to the new subsidiary to provide the resource backing for its debt reorganization efforts
for individual countries.
The basic task of this IMP subsidiary will be to find a country by-country settlement within the framework of an enlarged consen-sus on a viable long-term solution. Such a solution must (a) stretch out maturities; (b) reduce interest costs to a defined ceiling of export earnings; (c) apportion adjustment costs between the indebted nation and its external creditors; (d) protect new lending levels; (e) ensure more markets, sometimes even through counter-trade; (f) reverse declining resource transfers; and (g) reach a new equilibrium in the balance-of-payments at a higher, not a lower, level of development activity. It will not be easy to reach such a solution in each case. It would require moving on two fronts simultaneously - the indebted country's domestic front, which is the current preoccupation, and on overall external policies which are getting ignored in actual practice. It would also provide more resources and more breathing space so that the present short time periods allowed for adjustment can be suitably lengthened. It would provide a built-in functional coordination with other international institutions, both at the management and staff levels.
It is not necessary at this stage to sketch out the role and the mandate of the new IMF subsidiary in great detail. What we need initially is a consensus - however fragile - to travel down this path, a consensus that may be sought in the meetings of the Interim and Development Committees. From

these deliberations, let us hope, there will be the birth of a new initiative, a reaffirmation of the commitment that the founding fathers made about forty years ago.

In focusing exclusively on the debt issue and in advocating a partial solution, I do not wish to disappoint those who fervently believe in fundamentall solutions and in comprehensive global negotiations. The pressure for such negotiations must continue. In fact, I see a complementarily, not a contradiction, in the two approaches. The destination can only come nearer with each confident step.

But while we pursue the idea of an IMF Debt Refinancing Subsidiary, there are at least three other urgent issues on the international timetable which must not be ignored:

- First, with IDA VII replenishment of only US$ 9 billion, the concessional flows to developing countries have been
greatly reduced at a time when China has also become a claiment for IDA resources and when Africa needs sub stantially larger concessional flows to reverse the present disturbing trend of declining per capita incomes. Sup
plementary concessional resources, in one form or another, are absolutely essential. Tactics must, however, suit the
political realities. If the present concern with Africa will evoke a more favourable political response, then let us float the proposal for a special Africa fund to be managed by the World Bank. If U.S. food surpluses offer a more acceptable basis for donors, then let us formulate proposals translating these surpluses into long-term concessional assistance while others offer cash contributions. If the interest in an SDR-IDA link is revived again, then let us seize upon this to open a new window for IDA. In other words, it is imperative that concessional flows are enlarged in the near future since, without that, poor countries and international cooperation would have suffered an irreversible hemmorage. The actual forms and mechanics for channelling these flows can be substituted to the prevailing politid environment.
- Second, we urgently need a fresh round of global trade negotiations, under the joint umbrella of GATT and UNCTAD, to address current restrictions on world trade. The prospects for such negotiations may improve with the current faint hurts of a world economic recovery. These trade negotiations must cover this time agricultural protectionism and restrictions on trade in services (including international migration), besides the usual preoccupation with manufactured goods. The attempt should be to make them the most comprehensive trade negotiations which can meet the enlightened interests of all parties.
- Third, careful and professional preparations must be undertaken now to make possible the holding of a new Bretton Woods Conference in 1985 or 1986. Sooner or later, some discussions on a modified Bretton Woods arrangement will start. This is the stage to get the position papers ready. Let me conclude by stating that the stakes are awesomely high in finding a viable solution for the deepening debt crisis of the developing countries. What the world needs today is not elegant analyses but a few practical steps, a feww workable solutions, however modest, however short of our ultimate ideal. We must start here aprocess, a process of responsible change, whose logic proves irrevers ible and whose momentum is carried over to finding more funda mental and basic changes in the international order. And let me respectfully suggest that while many of us in the developing coun-tries are bruised and battered today, and while the bitterness of our immediate experience may sometimes overwhelm the calmness of our analysis, let us at least try to win respect in the international bra by the force of our arguments, not by the force of our language. It is in that spirit that we must address the international economic issues.

CHAPTER 17

Excerpts from Plenary Speeches

Kurt Waldheim

The effects of the continuing economic crisis on the development of poorer countries are well known to this group - unfortunately they are less well known, if perceived at all, by public opinion in developed countries. For this reason I congratulate the organisers of this Roundtable - The North-South Roundtable and the UNDP Development Study Programme - on defining the topic before us in such a way as to link monetary and financial issues to those of sustained development, particularly of human resources. The development of human resources is a medium- and long-term process, as are the wider objectives of economic and social development. This longer-term process demands sustained efforts, political consensus, long-term investments

and careful management in developing countries. It is this process which has been halted and even reversed in many developing countries by the current crisis, by the succession of ad hoc responses, and by the continuing imbalances, fluctuations and uncertainties of the present dangerous situation. I believe that when we look back a few years hence at the events of the present day, we will regretably see all too clearly the real costs to the world - even to the developed nations - of this breakdown of the development process in many countries. This breakdown has been brought about by our failure to manage international financial and monetary problems, by our failure to admit our mistakes and learn from our experience and, perhaps above all, by the unwillingness of some key parties concerned even to recognise the need for some management of the problems we face.

Of course the vital need for confidence in the current monetary and financial arrangements is widely recognised; but this is too often used at the official level as an excuse not to face the urgent issues directly. Such unofficial discussions, as this Roundtable, are therefore essential to focus public attention on the fundamental problems we face, and I hope, to move towards consensus on solutions.

You will hear, in the next three days from a variety of speakers with profound knowledge of these issues - from creditor and debtor countries, from private banks, international organizations and the academic world. You also have available a number of excellent papers. I will not therefore detain you with my own views in detail, but! do wish to raise a few points of importance.

The first point derives, from my experience at the United Nations, intimately concerned with the struggle to reform the international economic order. It is now perfectly clear that the world community has drifted into a highly threatening situation in which the risks of collapse of the international monetary and financial systems are real, with serious implications in other areas, such as trade, growth and employment in both developing and developed countries. What can we learn to help us in the future by honestly facing the question of how this situation, desired by no one, has come about?

Some fervently believe that we can, and perhaps should, learn nothing. They believe that continuing ad hoc measures, restrictions and deflation in developing countries and unrestrained movements in exchange and interest rates will resolve the present accumulated problems and prevent their recurrence, in future. An increasing body of opinion now believes, however, that a coherent set of policies is indeed required to manage these problems, and that after careful consideration and consultation, significant changes will be required in international arrangements to reach and preserve a comprehensive and equitable solution.

This fundamental division of opinion between a laissez-faire, ad hoc approach, and the coherent overall management of the international debt problem lies at the heart of our inability to respond to the current crisis; it has been at the centre of the debate at the United Nations and elsewhere.

In one important respect, the field of money and finance offers the prospect of a breakthrough towards greater international cooperation and concerted action. This is because the reality of interdependence has become apparent to public opinion in the developed countries. Indeed, the prospect of breakdown threatens employment, growth and economic stability not only in the developing countries, but in the developed countries also. There is thus, perhaps, a possibility of growing consensus, cooperation and effective action in regard to the issues before you. I hope, however, that the damage will not become even more substantial before this comes about. Expansionary policies, failed to make productive use of borrowed funds, allowed their key prices to become unrealistic, or neglected to develop or moblizie their abundant human resources.

A number of developing countries which had already restructured their economics or which had borrowed relatively litter, succeeded in riding out the crisis, although often at the cost a setback to their growth. But many countries in Africa and Latin America, in addition to a few in other regions, found that they were unable to service their debt.

Response to the Debt Crisis

The international community responded to the debt crisis with a series of ad hoc measures. In some cases, bridging finance was provided to enable countries to maintain a flow of essential imports and to limit arrears while an adjustment programme with the Fund was being negotiated. Successful negotiation of such a programme yielded a fund loan and debt rescheduling, together with a limited injection of new money from the commercial banks. The IMF played a critical and innovative role in inducing the banks to roll over maturing debts and inject new money to provide the minimal inflow of external resources needed to finance projected current account deficits.

The modalities of the adjustment process were debated at the Santiago Roundtable. The

Roundtable agreed that the rapid adjustment already evident was being achieved at an inordinate cost in terms of the economic and human development of the debtor countries. It affirmed emphatically that adjustment should be designed to expand exports and the efficient production of import substitutes, rather than to suppress imports through policies of austerity. Policy measures for adjustment should not be sacrificed for short-lived gains in material production. It recognised that an increased imphasis on such expenditure switching, rather than on expenditure reduction, would require increased lending by creditors during the adjustment process. A number of proposals were made to that end. It called on the IMF to give substance to the right of borrowing countries to design their own adjustment programmes reflecting their own priorities, while recongnising that the Fund needs to satisfy itself that the policies will indeed achieve adjustment.

The Vienna Roundtable concluded that recent experience reinforced this critique. Several countries, notably Brazil and Mexico, have made spectacular improvement in their trade balance, including in recent months export expansion. The costs have nevertheless been high, particularly in terms of loss of productivity and employment and a sharp deterioration in the living conditions of the poorest people, because the peremptory character of the adjustment that was dictated by the shortage of expansion began to materialize, and because there were delays in moulding progrannes to changing country circumstances. Moreover, a significant part of the export expansion that was achieved has been swallowed up by the recent increase in interest rates is a continuing threat to sustained recovery and a constant temptation to consider default.

The lengthy debate between the proponents of a country-by country approach to the debt problem and the advocates of generalized solution should now be concluded with an honourable compromise. There is indeed a need for agreement on general principles and guidelines, and for a consistent revision of past practices that have ceased to be appropriate. But these general principles need to be applied flexibly on a case-by-case basis to take account of the particular circumstances of individual countries.

The Debt Crisis and Trade

One of the key characteristics of the successful Asian economies, which have managed to adjust much better to adverse international circumstances, is their orientation to external trade. They have for some years exploited, not combated, their comparative advantage in producing labour-itensive manufactured goods. The result has been a dynamic growth of exports that has enabled them to sustain their debt service obligations while simultaneously financing the rising imports required for economic growth.

The Roundtable concluded that it was important to analyse the experience of the more successful countries to see whether other countries in similar circumstances could benefit from such experience. There is, however, some danger that widespread emulation of the strategy of export-led growth may, in the short-rum, depress the terms of trade of the developing countries.

The second point I wish to emphasize is the important relation between the problems of debt, money and finance on one hand and the prospects for peace on the other. In a developing country, measures to address the debt problem through deflation, cut-backs in essential imports or the orientation of production to exports, can lead to growing social and political tensions, threatening the political stability of the nation and the relations of one nation with another. For both economic and political reasons, therefore, all parties concerned - creditor countries, debtor countries and private banks - have a real interest in working together to resolve these dangerous problems.

I would particularly plead therefore that those responsible in both public and private sectors in creditor countries strive to reach a genuine understanding of the real human costs incurred in debtor countries, and thus of the very real political limitations on the action of their governments. I would also plead that leaders of developing countries try to appreciate better the reality of the internal political pressures which limit the freedom of action of the governments of the developed countries. A better understanding on both sides will not of course resolve the problem, but it will make easier the emergence of the consensus on which any solutions must be based.

Bradford Morse

Over the last 90 years we have come to understand that development has not only been elusive as a concept but it has also eluded convincing measurement in practice. I believe that as a result of this emphasis, an overwhelming portion of development assistance has centered on the transfer of capital instead of an intensification and improvement of the human skills, managerial abilities and the development of appropriate institutional infrastructure in the countries concerned.

Without question, capital is essential anfl indispensable for growth and economic progress and to enable an economy to participate at a larger degree in international exchanges. But I am convinced that central focus of much development planning on the capital side has obscured the even more essential and indispensable necessity to develop human resources and institutional infrastructures, if the product of capital investment is to be sustained and maximized. Human resources development does not involve exclu- sively - as is commonly understood - only skill formation, this is only part of it, albeit an important part. Human resource development also has psychological aspects - to enable individuals to acquire confidence so that they may become effective producers.

One frequently hears reference to the Marshall Plan and to its success in post-war Europe as a suggested strategy to stimulate development in developing countries. It is sometimes proposed that all that is required is to put in place a properly endowed new Marshall Plan and all the poverty, misery, problems and underdevelopment would wither away in the more than scores of countries which suffer from it. Yet the Marshall Plan primarily, indeed principally, involved a transfer of capital to the countries of Europe severely destroyed by World War Two, countries which had highly developed, human infrastructures in place for many generations before the outbreak of the World War, countries with long experience in creating and effectively operating the institutions and structures necessary for economic and social progress.

The Marshall Plan was clearly identified as a program of recovery and reconstruction. I do not believe that any informed person has ever called the Marshall Plan an exercise in development. The objectives of development in Europe had already been met long bcfore the war.

But the success of the Marshall Plan has had a seductive effect on development which persists to this day, resulting on an emphasis by both developing countries and development institutions, bilateral and multilateral, on physical capital rather than human capital. Human capital formation involves physical considerations - health, sanitation and so forth; it involves cultural dimensions - the individuals have to be given the opportunity to be creative within their own environment. It must be understood that a country's population is its principal resource, without which no program will succeed. Governments must be encouraged to adopt policies which will allow a steady expansion of their human resource base. And this, in turn, implies that individuals be given a sense of dignity and worth - incentives to contribute to the best of their abilities and opportunities to understand that their contributions are made towards a common goal.

Obviously such policies require investment - and it is equally clear that the attainment of a more sophisticated level of skills requires a certain degree of capital available to make it fully productive.

Bernard Chidzero

The nature and magnitude of the problemm the world faces cannot be in dispute any longer, given the background of so many well-researched reports and so many authoritative works of one kind or another by individuals as well as by institutions and international organizations. This Roundtable is only too familiar with the issues and has made a significant and measurable contribution to the ongoing debate. The critical elements of what is truly aa crises are ascertainable:

A pervasive world recession from which sustained recovery is now descernible but by no means yet assured. Growth in production and demand desired by all, yet the spectre of inflation scares those who hold the reigns to that full recovery while unemployment remains a stark and frightening reality.

Stubborn and enervating current account deficits on the part of the overwhelming number of developing countries, and energy sapping surpluses on the part of others.

Stagnation or actual declines in the gross domestic product of countless countries aggravated and indeedexacerbatedby acute balance-of-payment difficulties and the shortage of foreign exchange, colossal debt burdens of developing countries, made even heavier by high interest rates and the over-valued U.S. dollar and poor commodity terms of trade.

Negative transfer of real resources by the majority of developing countries because of debt service payments and also because of decline in capital flows to these countries. For the low income countries, stagnation or decline in the volume of official development assistance and UNDP resources in relation to previously and internationally agreed target of 0.70 percent of GDP.

Critical also is the liquidity issue and yet the fear of inflation seems to stand, mistakenly I think, in the way of SDR creation when this is the needed and obvious solution of part of the trade problem.

Finally, what of protectionism and the alarming or resurgent economic nationalism which seems to go with it so antithetical to greater liberalization a la GATT and so inimical to Inter nationalism generally, but more cruelly, so destructive of the industrialization efforts of developing countries whose manufactored exports are threatened everywhere.

Little wonder then that the reports are full of grimafacts and counltess meetings echo with the magnitude of US$ 800 billion cumulative medium- and long-term debts of the Third world, over US$ 100 billion in debt payments with debt service ratios rising for some countries to over75 percent of export earnings.The centre can no longer hold and the parts fall apart. The international economic system is breaking at the seams and the monetary, financial and trade elements of that system which serves the whole world fairly and its individual members equitably and with sensitivity to special circumstances.

I now turn to focus on the African situation and so throw some light on the nature of the African crisis. I must firs emphasize that the debt problem in African must be understood against the background of the specifice and dramatic economic crises that exists in that countinent today – what I would term as the African syndrome and I refer of course to sub-Saharan Africa. This crisis is characterised by declining gross domestic product (GDP) both in absolute and per copita terms; declining terms of trade and export earning; chronic foreign exchange shortages and difficult current account and trade deficits. All these negative trends tend to reinforce each other.

Let me briefly quantify some of these. Where GDP had grown at an average of about 4 percent per year, during the decade ending in 1980, it has been fallin gsince then. Income per capita is estimated to be about 4 percent below the 1970 level, and yet population growth is over 3 percent per annum. Much of Africa south of the Sahara has been devasted by three years of deought. Other natural calamities include desertification and siltation of riverbeds. Agricultural production per capita has diclined at the rate of at least one percent during the same period.

The 1984 World Development Report suggests that even with some fundamental improvement in domestic economic performance, per capital income in sub-Sahara Africa will continue to fall for the rest of 1980. Real incomes in Africa by 1995 could be so low that as much as 80 percent of the people will be below the poverty line, compared to about 60 percent now.

The terms of trade have moved negatively by minus 5 at least during the period since 1980. Prices of non-oil primary commodities declined by 27 percent over the same period, in current dollar terms. The loss of income due to this deterioration in terms amounted to 1.2 percent of GDP for sub-Saharan Africa as a whole; for middle income oil-importers the loss was 8 percent while oil-exporters recorded a slight gain of less than 1 percent; with the low-income countries losing about 2.4 percent of GDP in this respect.

In such a difficult economic situation African governments have needed all the financial resources they can get in an attempt to sustain and maintain development programs. The debt problem which had been slowly building up surfaced with a vengeance since about 1980, coinciding with the general decline of the African economies on all fronts that I have outlined above, reinforcing as well as being exacerbated by it.

An estimate of Africa's debt, defined as disbursed and publicly guaranteed medium- and long-term debt, is put at a figure of about $ 50 billion. Compared to other areas of the world the absolute magnitude could appear to be bearable. However, the problem is dearly alarming and unsustainable when the capacity to service this debt is brought into the picture. For at least one country the external debt was estimated to be more than seven times that country's export earnings in 1988.. Even with some rescheduling under the usual terms this country would still face a debt service ratio approaching 100 percent for the rest of the 1980s. There are other countries whose ratios are no less alarming, a good many of these with rains as high as 70 percent, though the African average is about 23 percent.

I have already alluded to the reasons for the sharp rise in debt and they are similar to those in other regions of the world, i.e., the strengthening of overvalued dollar, rising interest rates, world recession, to name but some. Any rescheduling that has taken place in Africa has been along conventional lines, providing only short term relief. A greater proportion of the debt consists of previously rescheduled debt which as a general rule is no longer eligible for rescheduling. In some countries IMF loans are falling due and the ability to pay from own resources is not always there, and this necessitates further borrowing.

Needless to say, the situation is different between countries because of this diversity of economic situations, a diversity which is well-documented in various studies, including studies by international organizations. But there can be no doubt that the debt problems of Africa are now very acute, especially so given the difficult economic situation on other fronts, including, in particular, insufficient external capital inflows, and the acute food problems and foreign exchange

requirements to finance the importation thereof.
While sub-Saharan Africa's share of otherwise stagnant or de dining Official Development Assistance increased in the past few years, net capital flows from private sources have declined by as much as 50 percent since 1980. Other worrying factors are bilateralization of ODA, its increasing politicization, commercialization as well as reduction in the multilateral component of ODA. This latter trend is evidenced by the underfunding of international development institutions (WA, UNDP, WAD) - institutions which are of particular significance to Africa and especially the low-income countries.
Growing at a rate of over 8 percent per annum, the population dynamics have serious implications given the reduced capacity of the public sector associated with diminished revenue flows and the insufficient foreign exchange. Here also the debt problem tends to grow and to feed itself.
For the African countries in particular, but for the Third World as a whole, perhaps something of a three-pronged approach is called for. In the first place, we need national self-reliance policies and efforts based on clear analysis and grasp of real issues and problems, especially as regards resource development and management, and intersectoral pricing policies to sustain and propel growth and development. These policies should go beyond national efforts to regional integration. But all these will come to nothing if there is no parallel or corresponding facilitative and supportive change in the international environment. Hence the second supporting approach must be directed at the many ills and obstructions in the international economic system, principally against protectionism, price fluctuations, lack of liquidity in trade, decline or fluctuations in resource transfer, both public and commercial. This approach must, in particular, address itself to the foreign exchange constraints and the debt burden. Concerted international action is clearly critical now, more so than before.
In the third place and finally, specially tailored programs must be designed for different categories of countries; this is especially important for the African region.

CHAPTER 18

Vienna Statement

Without, new initiatives to resolve the most pressing problems confronting the world economy, there is a danger that the debt situation will lead to catastrophe and a near certainty that many debtor countries will remain subject to devastating human and economic costs.
The Vienna Roundtable, which was convened to examine the debt crisis, reviewed recent experience and evaluated new proposals, The Roundtable recognised that the pursuit of ad hoc policies had been successful in buying time, but urged that the success in averting a collapse of the international financial system should not engender complacency- It noted, in particular, that current projections envisage a continuing decline in per capita income in sub-Saharan Africa and a recovery in Latin America so slow that the per capita income of 1980 would be regained only in 1990- The situation would be even worse if real interest rates continue to remain high rather than fall, as these projections assume- The perpetuation of the debt problem will act as a drag on the recovery in the industrial countries as well as weaken the impulses for the world economic recovery., The Roundtable affirmed its belief that these dismal prospects could be transformed by appropriate policy initiatives at the country and global levels.

Origins of the Debt Crisis

The debt crisis arose during 1981-82 when many developing countries lost their previous access to financial tgarkets- Such access was essential to the maintenance of debt service payments, particularly during a global recession.
The loss of creditworthiness suffered by many, although by no means all, developing countries can be traced to both external and domestic causes. The shocks in the external environment included abrupt changes in oil prices, the most severe global recession for half a century, very low commodity prices and the highest real interest rates in recorded history- A number of countries pursued excessively expansionary policies, failed to make productive use o£ borrowed funds, allowed their key prices to become unrealistic, or neglected to develop or mobilize their abundant human resources.
A number of developing countries which had already restructured their economies or which had borrowed relatively little, succeeded in riding out the crisis, although often at the cost of a setback to their growth. But many countries in Africa and Latin America, in addition to a few in other

regions, found that they were unable to service their debt.

Response to the Debt Crisis

The international community responded to the debt crisis with a series of ad hoc measures. In some cases, bridging finance was provided to enable countries to maintain a flow of essential imports and to limit arrears while an adjustment programme with the Fund was being negotiated. Successful negotiation of such a programme yielded a Fund loan and debt rescheduling, together with a limited injection of new money from the commercial banks. The IMF played a critical and innovative role in inducing the banks to roll over maturing debts and inject new money to provide the minimal inflow of external resources needed to fmance projected current account deficits.

The modalities of the adjustment process were debated at the Santiago Roundtable. The Roundtable agreed that the rapid adjustment already evident was being achieved at an inordinate cost in terms of the economic and human development of the debtor countries. It affirmed emphatically that adjustment should be designed to expand exports and the efficient production of import substitutes, rather than to suppress imports through policies of austerity. Policy measures for adjustment should be expansionary and not contmctionary. Human resource development should not be sacrificed for short-lived gains in material production. It recognised that an increased emphasis on such expenditure switching, rather than on expenditure reduction, would require increased lending by creditors during the adjustment process. A number of proposals were made to that end. It called on the IMF to give substance to the right of borrowing countries to design their own adjustment programmes reflecting their own priorities, while recognising that the Fund needs to satisfy itself that the polities will indeed achieve adjustment.

The Vienna Roundtable concluded that recent experience reinforced this critique. Several countries, notably Brazil and Mexico, have made spectacular improvement in their trade balance, including in recent months export expansion. The costs have nevertheless been high, particularly in terms of loss of productivity and employment and a sharp deterioration in the living conditions of the poorest people, because the peremptory character of the adjustment that was dictated by the shortage of external finance required savage cuts in imports before export expansion began to materialize, and because there were delays in moulding programmes to changing country circumstances. Moreover, a significant part of the export expansion that was achieved has been swallowed up by the recent increase in interest rates. The unparalleled height of current real dollar interest rates is a continuing threat to sustained recovery and a constant temptation to consider default.

The lengthy debate between the proponents of a country-by country approach to the debt problem and the advocates of generalized solutions should now be concluded with an honourable compromise. There is indeed a need for agreement on general principles and guidelines, and for a consistent revision of past practices that have ceased to be appropriate. But these general principles need to be applied flexibly on a ease-by-case basis to take account of the particular circumstances of individual countries.

The Debt Crisis and Trade

One of the key characteristics of the successful Asian economies, which have managed to adjust much better to adverse international circumstances, is their orientation to external trade. They have for some years exploited, not combated, their comparative advantage in producing labor-intensive manufactured goods. The result has been a dynamic growth of exports that has enabled them to sustain their debt service obligations while simultaneously financing the rising imports required for economic growth.

The Roundtable concluded that it was important to analyse the experience of the more successful countries to see whether other countries in similar circumstances could benefit from such experience. There is, however, some danger that widespread emulation of the strategy of export-led growth may, in the short-run, depress the terms of trade of the developing countries.

The prospects for successful export expansion would be immensely strengthened by a reversal of the protectionist trend in the " developed countries, as well as by a strengthening of the economic recovery currently in progress. There is also an established need for a sufficient flow of trade finance, especially for South-South trade.

The Roundtable noted with great concern the current trend towards bilateralism in trade which can be reversed not only through an early resumption of comprehensive new multilateral trade negotiations, but also through the implementation of the already existing commitments.

It was also suggested that the North-South Roundtable should consider organizing a series of dialogues specifically on the trade issue in view of its tremendous importance for world recovery and growth.

The Debt Crisis and Human Resources

The Roundtable noted the strong evidence that investment in human resources has a particularly high yield in the process of economic growth in the longer-term, as well as being a key determinant of improvements in the human condition. The experience of the successful Asian countries, which have for some years accorded a high priority to human resource development, reinforces this evidence. Despite this, the priority accorded to human resource development had been declining in many countries even prior to the debt crisis.
The lack of attention to human resource development and the lack of mobilization of available human resources through appropriate motivation have exacerbated to the indebtedness of many countries. The inevitable cutbacks in government expenditure caused by the debt crisis have, in many instances, fallen disproportionately on education, health, family planning, and other forms of human resource building. These areas deserve to receive an immediate increase in expenditure, even before general expansion becomes feasible. Greater attention must be given to issues of employment, income distribution and people participation.

Proposals for Action

The Roundtable achieved a significant measure of consensus on the steps needed to resolve the debt crisis. The fragile recovery in the developed countries must be sustained and extended to the developing world. A number of policy changes are needed in both developed and developing countries, reinforced by several new initiatives at the international level. Specifically, the Roundtable called for the urgent pursuit of the following proposals:
(1) The biggest single threat to the maintenance of expansion in the North and to a successful outcome to the adjustment policies that have been adopted in the South is posed by the unparalleled level of real interest rates. These interest rates reflect the particular mix of macroeconomic policies chosen by the major countries, and in particular the combination of an expansionary fiscal policy with a rigorous monetary policy in the United States. A phased reduction in the structural budget deficit of the United States, synchronized with a relaxation of monetary policy to sustain aggregate demand without reviving inflation, is urgently needed to correct the excessive level of interest rates.
(2) The Roundtable is convinced of the need for long-term debt rescheduling, and accordingly welcomed the recent preliminary reports of a comprehensive rescheduling arrangement between Mexico and the commercial banks involving some easing in financial charges and major extensions in the repayment period. While recognizing that further study is needed before final conclusions can be drawn, it is hoped that this arrangement may provide a precedent for the banks to reschedule the debts of other debtor countries that respect their adjustment responsibilities. The Roundtable further recommended that the creditor countries should encourage further adjustments in bank lending terns along the following two lines:

(a) Capping of interest rates, with capitalization of interest in excess of some agreed levels, and/or of interest charges in excess of a specified proportion of exports;
(b) A measure of commercial debt forgiveness for the poorest countries, in cases where there have been important adverse external shocks and where the government is committed to a long-run programmed of structural adjustment.
(c) With respect to the least-developed countries, the Roundtable believed that a strong case existed for cancellation of all official debts.
(d) The Roundtable agreed that serious consideration should be given to the proposal for setting up an IMF Debt Refinancing Subsidiary, perhaps jointly with the World Bank. The basic task of this IMF subsidiary would be to find a country-by-country settlement within the framework of some generalized principles for debt rescheduling. These principles should combine internal adjustments in indebted developing countries with efforts to modify some of the external conditions to ease the burden of adjustment. Any viable solution may include stretching out of short-term maturities, capping of interest rates, guarantees of new lending levels, some effort to restore the resource transfers from North to South and to enlarge trade possibilities of developing countries in collaboration with other international institutions and equitable sharing of adjustment

costs. The Roundtable recognized that the proposal for an IMF subsidiary is still in a preliminary stage but it urged that an institutional response must be designed soon to resolve the debt crisis within an enlightened framework without endangering the hearth and viability of the indebted nations or of the international financial system.
(e) A new round of multilateral trade negotiations, with a principal objective of increasing market access for the exports of developing countries, should be launched promptly. These trade negotiations must cover all items, i.e. agricultural commodities, manufactured goods and services.
(f) Many developing countries need to rethink their development strategies so as to give a higher priority to human resource development and mobilization and to exploit more fully the potential benefits of international trade. Such policies are a vital part of a solution to the debt crisis and not a luxury that can be postponed until the crisis is resolved. It would also be most desirable that concerned international institutions should undertake the preparation of an annual comprehensive study on the state of the human condition to focus national and international attention on people oriented development strategies. The Roundtable is strongly convinced that there is an urgent need for a serious and in-depth consideration by the international community of the important and decisive role of human resource building in the development process.
(g) In order to design such new development strategies and to ensure the necessary resources for their implementation, the developing countries may find it useful to build a consensus through a series of "Country Assessment and Resources Committees" composed of independent experts who are sensitive to the objectives of the countries involved.
(h) At its two previous meetings, the Nordusouth Roundtable on World Monetary, Financial and Human Resource Development Issues has advanced a number of suggestions for augmenting the flow of financial resources to the South. The Vienna Roundtable noted with deep regret the failure to replenish WA VII at an adequate level or to provide a supplementary facility as called for at the Santiago Roundtable. It noted that the question of a new SDR allocation would be discussed again shortly and strongly reaffirmed its support for a substantial allocation.

Appendix

Appendix A

Workshop Report
on
Debt Renegotiations: International Perspectives

Frances Stewart

The session, discussed the extent and magnitude of the debt problem, considering the type of solution appropriate in the light of this analysis (in particular whether ad hoc or general solutions would be desirable). Finally, some specific proposals were put forward.

Dimensions

There was general agreement that the debt problem in the early 1980s had been of very substantial magnitude. It was noted that currently between 60 and 70 percent of all outstanding debt was in trouble in one way or another. The quantities involved in Mexico in 1982 required resources well beyond those available in the Fund. However, it was noted that some countries, especially in Asia, had not experienced the same problems or where they had, had been able to overcome them rapidly. It was suggested that we could learn a great deal from examining the experience of these countries. Gustav Ranis' papers for this meeting and for Santiago had provided an important perspective on this.
While there was agreement that the debt problem had been of a huge - indeed alarming - magnitude for many countries, there seemed to be some disagreement about the extent of the problem today and prospects for the future. Many participants felt the problem remained very substantial and required new solutions. For example, figures were cited to show that there had been no improvement in the ratio of debt to exports in Latin America, and that the debt service

ratio in 1984 would probably be higher in 1984 than in 1982. Credit ratings, apart from Mexico, were worsening. Moreover,. to the extent that there had been any turnaround in the situation, this had been achieved at an enormous economic and social cost. The prospects were that by the end of the decade, income per capita in Latin America would be only just approaching 1980 levels, while in Africa per capita income was expected to fall throughout the decade.
According to at least one participant, there had been no solution to the debt problem. In contrast, a view was expressed that matters were proceeding satisfactorily and that no new initiatives were needed. Others (not present) were quoted as taking a similar view. The organic nature of the debt/creditor relationship was emphasized and it was suggested that achievements in this area should be weighed against costs and suggested alternatives. No suggestions were forthcoming, however, in how such organic achievements might be measured or monitored.

Ad hoc or General Solutions

There appeared to be considerable dispute here despite Mahbub ul Hag's earlier strictures that this was a sterile debate. The disagreement lessened during the discussion. It became clear that those who advocated "general" solutions recognized the need to take into account the particular circumstances of each country as well, while those who favoured an ad hoc approach saw the desirability of some general guidelines. Nevertheless, some differences remained. Previously the Fund had been accused of neglecting particular country circumstances when devising adjustment packages, presenting general solutions applicable to all countries; now the Fund rccognized country differences, and outsiders were pointing to the general nature of the problem. A representative of the banking community stated that he too opposed any general or global solution. There was a temptation to believe that the particularistic approach was a new version of divide and rule.
Those who saw the need for some general solution pointed to the simultaneous emergence of severe problems m a great number of countries, suggesting common origins of the problems; these common origins were identified as including world recession, high interest rates, the growing magnitude of floating debt, and protectionism in developed countries. But this did not mean that individual country mismanagement and misallocation of resources had not also made a significant contribution to the problems in many countries.
One important reason why a general solution was sought was to enable the weaker nations to participate. Ad hoc solutions may be satisfactory for large countries whose bargaining position is strong, but they are likely to leave the situation of low-income countries very weak. But while the intellectual case for some general solution seemed strong, thee current political outlook made it unlikely, since major developed countries appeared to oppose moves in this direction. Hence a country-by-country, or perhaps regional, approach might offer the best prospects from a political point of view for a solution in the near future.

Solutions

In considering solutions it is necessary to take into account the political situation, as well as the economic. This applies both to short term proposals and to longer-tern ones. The political dimension, which rests heavily on the way in which various interest groups are affected, may well differ in the short- and medium-term. Politics of the South need to be considered as well as politics of the North. Although the South has to date accepted considerable sacrifices to meet their debt commitments because they believe the advantages of the system outweigh the disadvantages, this may not persist indefinitely if adjustment costs continue to be so heavy. Consequently, some solution to the problem may be necessary in the medium term to avoid more radical action by the South.
Specific solutions were briefly discussed. It was argued that governments were not prepared, at present, to adopt solutions which would involve bailing out LDCs. Moreover, no one seemed anxious to accept a "market" solution, involving reselling debt at a discount. It was stated that a solution was especially difficult to find because of the hybrid nature of the debt situation - viz., that it consisted largely of sovereign borrowing from market institutions. This ruled out the sort of solution that had been adopted in the past (e.g. with respect to West Germany in 1959) for inter-government lending, and also purely market solutions involving, for example, bankruptcies. In the light of this, there was a proposal for the adoption of increasingly self-reliant development patterns among debtor countries.
A number of participants felt that Mahbub ul Haq's proposal for a new debt subsidiary in the IMF

presented a useful starting point. This dealt mainly with private debt of middle-income countries. It was, suggested that the problem of low-income countries, which was mainly a matter of official debt, could be dealt with by debt cancellation by governments. This would not be very costly and had already been adopted by Sweden.
Some participants argued that a return to the agenda of the New International Economic Order was required, and global negotiations with a special conference on money and finance. However, the past failure of this type of approach to make sub stantial progress was noted.
The broad conclusion of the session was that some global solutions were desirable, though not necessarily politically feasinle. Detailed discussion of particular solutions – staring with the Haq proposal –was now needed.

Workshop Report
on
Debt R enegotiations - Country Experience

Azizali F. Mohammed

The session was concerned with drawing lessons from recent country experience of debt renegotiations and examining solutions for some of the problems that were typically encountered.

Lessons

The Brazilian experience, as analyzed by Carlos Langoni, underlined the severe consequences of the unexpected withdrawal of short term trade facilities and interbank credit lines; the adjustment process was greatly complicated because it had to be undertaken in the context of zero or even negative liquidity. Second, the linking of disbursements under the new money packages with disbursements under Fund programs created a "quarterly syndrome" when performance criteria testing dates approached or when reviews were underway or when long delays occurred in modifying programs to changing conditions. This generated massive uncertainty, particularly for private sector firms. Third, banks tended to adopt market pricing criteria for essentially non-market situations, thereby adding to the burden of debt servicing costs. In this respect, the unwillingness of public institutions (with the exception of the IMF) to become more involved made the renegotiation process far more difficult and even the Fund wass content to propose quantity targets while leaving margins to be determined by the lenders.
Christine Bindert, drawing on the experience of Costa Rica, pointed to the problems that arose for small debtors from the settlements that were reached with the larger debtors because the terms for the latter were represented as what the "market" would accept. In this situation, imports became a residual and there was minimum help from public funds to cover the gap between market determined flows and development needs.
In explaining the Argentine experience, Gabriel Martinet referred to the change that occurred between earlier episodes of debt renegotiation when most of the debt was held by official creditors and the recent period when a greater part was owed to commercial banks (over 60 percent). As a result, the negotiating process had become far more complex and the insistence of lenders that debtor governments take over responsibility for debts of private borrowers had led to de facto nationalization of large areas of the private sector in a number of cases.

Solutions

Roy Takata proposed improvements covering the following areas: (a) currency diversificationn so that a portion of the debt was denominated in non-dollar currencies; (b) mold-year reschedul ings; (c) separating trade Financing from the rescheduling process; (d) interest capping with the support of international institutions; and (e) the catalytic role of public sector to induce much larger private sector capital flows.
In the ensuing discussion, there was a general recognition of the need for institutional arrangements to separate short-term trade facilities through a greater effort by the export credit insuring agencies to maintain the continuity of trade flows.
Currency diverisification was seen as one way o£ reducing the burden of interest charges, especially when these were lower than on dollar-denominated debt, although there was some danger of higher costs were the U.S, dollar to depreciate from current levels.

The multi-year rescheduling of Mexican debts was regarded as a useful precedent, although it raised difficult issues for the role of the Fund in the monitoring of settlements over long periods of time. The role of the World Bank and regional development banks in areas such as co-financing, especially of the later maturities or for lowering costs below market interest rates, was seen as important for inducing larger and more stable flows of private sector capital.

Another problem that was identified arose from the failure of debt negotiations to address the question of whether the debtor countries could be expected to remain net exporters of capital as this would become increasingly untenable with the passage of rime. Also, the manner and content of debt renegotiations was seen as tending to politicize financial relationships and as likely to risk destabilizing governments in a number of countries. There was no consensus on the issue of whether small debtor countries tended to lose from the settlements made by the larger debtor countries. Finally, issues of human resource development and the distribution of income were often overwhelmed by the imperatives of the debt problem; yet there appeared to be a certain connection between the debt crisis that had affected more acutely countries with large disparities of income and wealth whereas countries that escaped the worst had been able to exhibit a much greater degree of political discipline and leadership. It was agreed that there was a need for systematic studies of the countries in East Asia and elsewhere that had avoided debt renegotiations.

Workshop Report
on
Debt and Trade Link
John W.Sewell

The discussion centered around the papers by Custav Rams and M.G. Mathur, and the presentation made by
Sidney Dell.

The participants agreed that trade liberalization could be the positive side of the debt crisis and financial adjustment. There was a continuum of issues, beginning with debt financing, and going through structural adjustment and on to trade liberlization. It was felt that these should not be separated in discussion of the debt issue. Trade liberalization is one of the central, long –term issues for North-South relations, and the one problem area where creative action will be possible in the period ahead.

Some felt that the proper parallel to the current situation was 1974-75. At that time the rapid growth in liquidity of the OPEC countries could have led to new mechanisms for financial transfers in North and South. But, instead, the task of recycling was left to the private banks, with results that are now being seen. In 1985-86 there may also be a major opportunity for North-South trade liberalization because trade clearly offers the opportunity for a variety of mutual bargains between the exporting and importing sectors within countries and between financing, debt policy and trade policy is particularly important.

The discussion then turned to the issue of structural adjustment – how debtor countries adjust to their new and more situation. The Mathur paper drew an important distinction between whether adjustment would involve “import contraction” or “export expansion”. The weight of the opinion within the group fell on the side of export expansion, with trade liberalization seen as a key element, particularly as a lubricant to long-term structural adjustment.

The Rains paper called particular attention to the need for dealing with issue of structural adjustment over a much longer term frame, with long-term development goals in mind. Too much of the current rescheduling of debt, according to Ranis, is short teen, ad hoc, and without any long-term targets in mind. The issue laid out in his paper is. not simply one of more liquidity versus more austerity, but the "appropriate use of temporarily larger levels of liquidity to effect the longer-term structural changes agreed upon by all parties". Present arrangements are simply not up to that task. There was much discussion of the Ranis paper with questions raised particularly about its political feasibility. However, a number of the members of the group indicated that it be specifically endorsed by the Roundtable membership. Some questions were raised, however, about whether the proposal was as applicable to the countries of sub-Saharan Africa, which are in a much different debt situation, as to the newly-industrializing countries, particularly in Latin America.

There was further discussion of the need to broaden internal markets within developing countries as a means of helping with adjustment, and a particularly important discussion of the issue that structural adjustment brought costs to the North as well as to the South. Mathur pointed out that there had been a 20 percent decrease in the imports of the 16 most heavily indebted nations, and

the impact on Northern exporters had been particularly strong. (A separate study by the Overseas Development Council, indicated that as a result of recession in the Third World during the period 1980-83, the United States had lost more than a million jobs due to a decrease in exports to the Third World. This is equally true of other industrial countries with major markets in the Third World. These losses would continue to be felt until a long-term process of structural adjustment permitted renewed growth within the developing countries.)

The discussion then went on to the dilemmas of protectionism - in both North and South. The Mathur paper discussed the new forms of protectionism which were arising in the industrial countries, particularly the use of non-tariff barriers. Their introduction would make new trade negotiations especially difficult.

Other participants raised the question of whether the developing countries will ever feel they can give up the preferential and differential treatment that has been a feature of North-South trade relations since the post-War period. This discussion raised the difficult issues of when countries "mature" into full participation
in the international trading system.

Several developed-country members raised the issue of whether there is an alternative to immediate trade liberalization. Industrial countries do, after all, have problems of structural adjustment within their own economies, and the pace of change, therefore, is particularly important. Other participants stressed the importance of South-South trade - trade between developing countries - with Frances Stewart raising the issue of,how such trade was to be financed in a particular situation when most developing countries lacked export finances for North-South trade, let alone South-South trade.

Almost all participants stressed the crucial importance of a new round of trade liberalization; although, there was a divergent view which felt that bilateral or regional trade arrangements, while a second best solution, were politically much more likely in the near term than a new round of multilateral trade negotiations. One participant mused as to whether it would be possible to arrange special bilateral trade arrangements between major debtor nations and their major creditor countries.

If there were to be a new round of trade negotiations, developing-country issues would have to be stressed and there would have to be full developing-country participation. Some developed-country participants stressed the historical reluctance of the Third World to be engaged directly in GATT negotiations. They argued that GATT was perhaps the "last best hope" of the developing countries because it was one of the few remaining defenders of trade liberalization.

The crucial problem would be to assemble a "package" of bargains which would have something in it for all countries - whether developed or developing. Of particular importance here was the question of trade measures which would help the low-income countries who bad received only a very small portion of the trade gains made by the developing world in the)960s and 1970x. There is a need for more analysis and policy development on trade measures which would benefit the low-income countries.

Several U.S. participants stressed that the rest of the world should understand that the United States is very serious about a new round of trade negotiations in 1985-86. Trade liberalization fits with the ideology of the Reagan administration, and leadership within the administration on trade issues is very strong. The motivation behind the U.S. policymakers was to prevent a retreat into pro-tectionism by assembling a "coalition of gainers" (from new trade liberalization) rather than the current "coalition of losers" (which is pushing protectionist measures). Trade is perhaps the best area for the United States to participate in any renewed form of global negotiations. And if both the Europeans and the developing countries do not fully realize this, a major opportunity will be lost.

Finally, all participants agreed that trade is a particularly important area for future work by the North-South Roundtable. The various parties were not only far from agreement, but were even far from understanding each other's positions and constraints in the area of trade liberalization. The role, therefore, for nongovemmental discussion and analysis is particularly important. The members recommended strongly that the North-South Roundtable make trade a major part of its work program in the future.

Workshop Report
on
Impact o f Debt on Human Resource Building
and Development

Hans d'Orville

Recent Experience

Two papers served as starting points for the discussion: one by Uner Kirdar on the impact of debt on human conditions and human resource development, the other by Francis Blanchard on the impact of debt on employment.

It was undisputed - as has been acknowledged in the Istanbul Statement - that the building of human resources was an essential prerequisite for the development of countries, the growth of their economies and the maximum utilization of capital investments. Yet human beings are frequently treated as a means, and not as the objective of development efforts. This fallacy finds its parallel in adjustment programs of many developing countries faced with large balance-of-payment deficits. Accordingly, social programs are significantly cut and an inordinate burden is placed, on the poorer segments of society.

Unfortunately, the current state of national statistics in many countries do not allow for an exact measurement of the impact of debt-related cutbacks in the social areas. The central features of IMF inspired adjustment programs relate to the promotion of exports and the control of external demand as well as the reduction of public expenditures. Evidence, however, has been mounting over the past few years that human resource development and social programs are being cut as a consequence and that human capital formation through education, training, etc. is being hampered. The decline in GNP, increase in unemployment, reduction in salary and wage levels, rises in food prices, lowering of nutrition levels and curtailment of educational and health expenditures - observed in virtually all African and Latin American countries-have significant detrimental effects on the human and social conditions. It was argued that in view of the scarcity of domestic finance and declining international creditworthiness of many developing countries, special emphasis should have been given to relatively cheap and potentially highly-productive human resource development programs.

To minimize the negative implications and costs of traditional adjustment programs, carefully designed policy measures are required both at the national and international levels, which would ensure long-term economic viability and uninterrupted continuation of systematic development efforts and employment policies. With respect to employment, detailed guidelines were offered on bow effective and social-oriented adjustment measures could be devised.

Principal Considerations

In the discussion it was noted that the special focus on the specific features of human resource development was not a new one. A few decades ago the quality of the labor force and improvements of an economy's base had been major policy concerns and were associated with the emergence of the economics of education and health. Today's concerns, however, are extending beyond the previously exclusive focus on skill formation and improvements in health levels. The term "human resource development" has been enlarged to comprise aspects of managerial, organizational and research skills, participation in decision-making, and social and cultural dimensions. On the basis of such a broad definition of human resource development it was difficult to determine how much should be invested in various programs at any given level of develop ment. The development of qualitative indicators might therefore be necessary to supplement employment adjustment policies

It was suggested that, in general, traditional might have ominous long-term consequences which needed to be redressed. In Western countries attention had recently been devoted to thee requirements and implications of post-industrial societies, but present emphasis was reverting to a discussion of how re-industrialization o£ developing countries could be accomplished. By the same token, it appeared that the call for a new international economic order was becoming muted and that instead, a situation had arisen where poorer countries were forced to adjust extensively to the precepts of the old existing order.

It was also argued that a casual relationship existed between indebtedness and the reduction in human resource development programs. A lack of attention to human resource development and a lack of mobilization of available human resources have contributed to the indebtedness of many countries where development of human resources are now even further eroded as a direct result of indebtedness.
It was generally recognized that the elaboration of adjustment programs, giving adequate recognition to the social dimension, would require the full participation and cooperation of all actors involved: national and international decision-makers and organizations, international banks and individuals, and mass organizations in countries concerned. In particular, it was suggested that stronger links should be established among the World Bank, IMF, UNDF and such agencies as the ILO. Further, national policies had to be complementaryy so as to deal with the economic, social and political problems resulting from adjustment programs. At the international level, complementary efforts should be undertaken to safeguard the basic needs of the population in the countries undergoing adjustment and economic restructuring.
The participants at the session were unanimous in their view that in the adjustment effort each country faced a difficult choice between a short-term balance, accomplished through traditional IMF-prescribed and finance-oriented programs, and a long-term balance. While exclusive attention was now being paid to short-term aspects, there was a consensus that a shift in focus was urgently required to take full account of the long-term implications o£ adjustment for development.

Short-Term Aspects

There was full agreement that, at the international level, the present adjustment programs, covering only a brief period of time, had to integrate a number of new criteria to reflect social and human dimensions more appropriately. Indicators capturing levels of poverty, education, management and skill formation, the degree of hunger and malnutrition and aspects of food availability might be particularly relevant and might also help to convey to the general public the severity of the situation of countries.
With respect to the national level, it was emphasized that governments could reduce the negative impact of conditionality through modified policies. The experience of Argentina suggested that cuts in the defence budget could mitigate the required reduction in the social budget. Through adjustments in both areas, an overall reduction in budget deficits could be accomplished, thereby distributing the internal burden of adjustment in a more equitable manner. Moreover, the mix of adjustment policies at the national level could be devised so as to protect more vulnerable groups from unacceptable sacrifies (e.g. in terms of food prices, education or health programs).
At the international level, international financing and funding organizations should strive to improve projects and their quality. Moreover, projects entailing employment creation should be favoured.

Long-Term Dimensions

It was stated that if a prevailing consensus of the 1970s, that concessional finance is an essential requirement for development, were to be eroded, it would be difficult to recapture it. Yet the present indicators are alarming. Investment levels in developing countries, both in terms of physical infrastructure and of human resource development, are decreasing. The pattern of world economic development is so uneven that a globally registered recovery might bypass the developing world, reducing in turn the employment rates and access to fresh capital in industrialized countries. This would inevitably cause lower levels of worldwide recovery and development in the long-run. The devastating costs of such a turn of events could not yet be fully quantified and assessed, but the participants felt that corrective measures were urgently required to mitigate the impact on human resource development.
In today's situation, where the external options and access to new £mane are lacking or diminished, developing countries have to redesign their development strategies with a view to managing better what is available; and it is precisely at this moment that human resource development efforts are being reduced. If a financial balance were to be achieved at the expense of a development imbalance, it is unlikely to be sustained and might lead in a downward spiral to further crises, a reduction in creditworthiness and continuing development losses. Such a scenario would signal grave dangers for the stability of the political system of the countries concerned.

Proposals for Further Action

It was suggested that in a comprehensive annual report on the state of human conditions, for which UNDP could serve as focal point, the relevant statistical data could be assembled to enable a regular assessment of a country's social situation in its development process, short-term cost of its present adjustment programs and long term loss of its productivity. A report of this type might form a useful basis for persuading bankers, the IMF and governments that periods of adjustment had to be lengthened to avoid excessive repercussions on human and social conditions, to minimize the cost to the poor and to mobilize available resources. Furthermore, such an analysis outlining the enormity of the tasks and the existing poverty and social problems could be a fast step in a process to rebuild, on a worldwide scale, a constituency for development assistance, especially at the multilateral level.
In general, it was felt by many participants that greater public understanding of the problems and costs involved in present adjustment programs was indispensable for a required reorientation and the safeguarding of development.
Another proposal called for the creation of a new human resource facility through which people-oriented and grassroots initiatives would be explored, promoted and supported. This was not intended to be an investment-type facility as such, but would rather aim at supporting participatory action research activities in the field.

Appendix B

Participants* at the Vienna Roundtable

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and President, Society for International Development, Rome
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SHAHID J. MURK!
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BERNARD CHIDZERO
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* Participants attended in their personal capacities. Affiliations are for identification purposes only.
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APPENDIX C

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 150 and in smaller sessions cotavened 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.

Ongoing Programs

The North South Energy Roundtable. The North South Energy Roundtable is a forum for dialogue on energy issues. The Energy Roundtable works to put energy in its proper international and 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 fora, to gather and relay information on national, regional and international energy policies and needs and to establish a dialogue with high-level policymakers 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 for the establishment of national, regional and international food reserves.
The Global Round The Global Round is a program of study and discussion on the North-South negotiation process. 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.
Roundtable on Money and Finance. This is an informal process of dialogue among policymakers in the public and private sectors, to initiate appropriate policies for the resolution of the current crisis in international finance. The Roundtable on Money and Finance has organized a task force of financial and development experts to assess the crisis - especially the fa~ws 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 Brandt Commission, edited by Khadija Haq, 1980.
NSRT, 120 pp.
Energy and Development: An Agenda for Dialogue, by Salah Al
Shaikhly and Mahbub ul Haq, 1980, NSRT, 25 pp.
Energy for Development: An International Challenge, by John Foster, Efrain Friedmann, James W. Howe, Francisco R. Parra and David Pollock, 1981, Praeger, 304 pp., paperback.
Energy and Development: Policy Issues and Options, by John Foster, Mahbub ul Hag and Francisco Parra, 1981, NSRT, 100 pp.
A Global Agenda for the Eighties, edited by Khadija Haq, 1981. NSRT, 128 pp.
Castel Gandolfo 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 Haq, 1983, NSRT, 231 pp.
Crisis of the 80s, edited by Khadija Haq, 1984, NSRT, 317 pp.
Adjustment with Growth, edited by Khadija Haq, 1984, NSRT, 336 pp.

Appendix D
The Society for International Development

is an independent nongovernmental organization whose purposes are to provide a forum for collective reflection and encourage a mutually educating dialogue on development, at all levels. The Society was founded in 1957 and has evolved into several interlocking networks - including its membership and chapter organizations - where individuals and institutions are linked in different ways around a varied range of activities.

SID'S major programs are as follows:

1. The North South Roundtable - an intervention into the dialogue at the international level;
2. The Alternative Development Strategies Program, along with the Society's journal, Development: Seeds of Change - Village Through the Global Order, acting as catalysts in the national level dialogue;
3. The Grass Roots Initiatives and Strategies - an attempt to link the knowledge and technology emanating from spontaneous people-oriented activities in industrialized and Third World countries at the local level.